

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **HONDURAS**

### **POVERTY REDUCTION SUPPORT PROGRAM**

**(HO-0212)**

### **LOAN PROPOSAL**

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## **BASIC SOCIOECONOMIC DATA**

For basic socioeconomic data, including public debt information, please refer to the following address:

<http://www.iadb.org/RES/index.cfm?fuseaction=externallinks.countrydata>

## INFORMATION AVAILABLE IN THE RE2/SO2 FILES

### **Preparation:**

1. Analysis of public social spending in Honduras. Consultant's report. Ricardo de Bernardi et al. July 2002.
2. Poverty Reduction Strategy Paper for Honduras. Government of Honduras, 2001.
3. HIPC Decision Point Paper. World Bank, International Monetary Fund, 2000.
4. Report on execution of social spending under programs and projects linked to the poverty reduction strategy (2000-2002). SEFIN, July 2002.
5. Poverty Reduction Strategy Paper. Joint Staff Assessment. IDA and IMF, 2001.
6. Matrix of the program's physical and financial targets

### **Execution:**

1. Matrix of indicators and targets broken down by gender and geographical area. Education sector. 2001-2005.
2. Matrix of outcome indicators for ex post evaluation.

## ABBREVIATIONS

ADEL	Asociación de Desarrollo Educativo Local [Local Education Development Association]
BIP-SISPU	Public Investment System, Integrated Project Database
FHIS	Honduras Social Investment Fund
HIPC	Heavily indebted poor countries
INE	National Statistics Bureau
PCU	Project coordinating unit
PRAF	Family Allowance Program
PRGF	Poverty reduction and growth facility
PRS	Poverty reduction strategy
PSS	Public social spending
SDP	Ministry of the President's Office
SEFIN	Ministry of Finance
SIAFI	Integrated Financial Administration System
SIERP	PRS indicator monitoring system
SISPU	Integrated Public Investment Monitoring System
SS	Ministry of Health
UNAT	Technical Support Unit

# HONDURAS

## IDB LOANS

**APPROVED AS OF SEPTEMBER 30, 2003**

	US\$Thousand	Percent
<b>TOTAL APPROVED</b>	<b>2,398,015</b>	
DISBURSED	1,944,357	81.08 %
UNDISBURSED BALANCE	453,658	18.91 %
CANCELATIONS	164,305	6.85 %
PRINCIPAL COLLECTED	688,847	28.72 %
<b>APPROVED BY FUND</b>		
ORDINARY CAPITAL	551,414	22.99 %
FUND FOR SPECIAL OPERATIONS	1,776,400	74.07 %
OTHER FUNDS	70,200	2.92 %
<b>OUTSTANDING DEBT BALANCE</b>	<b>1,255,509</b>	
ORDINARY CAPITAL	174,620	13.90 %
FUND FOR SPECIAL OPERATIONS	1,080,617	86.07 %
OTHER FUNDS	272	0.02 %
<b>APPROVED BY SECTOR</b>		
AGRICULTURE AND FISHERY	296,827	12.37 %
INDUSTRY, TOURISM, SCIENCE AND TECHNOLOGY	73,899	3.08 %
ENERGY	420,074	17.51 %
TRANSPORTATION AND COMMUNICATIONS	405,401	16.90 %
EDUCATION	71,293	2.97 %
HEALTH AND SANITATION	260,585	10.86 %
ENVIRONMENT	80,247	3.34 %
URBAN DEVELOPMENT	154,749	6.45 %
SOCIAL INVESTMENT AND MICROENTERPRISE	366,177	15.26 %
REFORM AND PUBLIC SECTOR MODERNIZATION	235,492	9.82 %
EXPORT FINANCING	6,908	0.28 %
PREINVESTMENT AND OTHER	26,362	1.09 %

\* Net of cancellations with monetary adjustments and export financing loan collections.



# HONDURAS

## STATUS OF LOANS IN EXECUTION AS OF SEPTEMBER 30, 2003

(Amount in US\$ thousands)

APPROVAL PERIOD	NUMBER OF PROYECTS	AMOUNT APPROVED*	AMOUNT DISBURSED	% DISBURSED
<b><u>REGULAR PROGRAM</u></b>				
Before 1997	4	53,900	44,227	82.05 %
1997 - 1998	6	172,106	96,357	55.99 %
1999 - 2000	12	206,049	77,099	37.42 %
2001 - 2002	15	180,243	18,936	10.51 %
2003	3	65,000	0	0.00 %
<b><u>PRIVATE SECTOR</u></b>				
2001 - 2002	1	13,700	0	0.00 %
<b>TOTAL</b>	<b>41</b>	<b>\$690,998</b>	<b>\$236,619</b>	<b>34.24 %</b>

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\* Net of cancellations. Excludes export financing loans.





Inter-American Development Bank  
Regional Operations Support Office  
Operational Information Unit

## Honduras

### Tentative Lending Program

#### 2003

Project Number	Project Name	IDB US\$ Millions	Status
<a href="#">HO0205</a>	Sula Valley Citizenship Security	20.0	APPROVED
<a href="#">HO0221</a>	Program to Foster Business Competitiveness	10.0	APPROVED
<a href="#">HO0220</a>	Poverty Alleviation and Local Dev. phase II	35.0	APPROVED
<a href="#">HO0218</a>	Pro-Bosque Program	17.5	
<a href="#">HO0212</a>	Poverty Reduction Sector Program	30.0	
<a href="#">HO0219</a>	Financial Sector Program	25.0	
<b>Total - A : 6 Projects</b>		<b>137.5</b>	
<b>TOTAL 2003 : 6 Projects</b>		<b>137.5</b>	

#### 2004

Project Number	Project Name	IDB US\$ Millions	Status
<a href="#">HO0208</a>	Strengthening of Fiscal Management	15.0	
<a href="#">HO0202</a>	Vocational and Technical Education Program	30.6	
<a href="#">HO0207</a>	PPP Roads Integration	50.0	
<a href="#">HO0195</a>	Sustainable Tourism	25.0	
<a href="#">HO1001</a>	Municipal Development Program Tegucigalpa II	22.5	
<a href="#">HO1002</a>	Health Sector Strengthening	25.0	
* <a href="#">HO0201</a>	Privatization Four International Airport	22.0	
<a href="#">HO0224</a>	PPP Energy Sector Support	50.0	
<b>Total - A : 8 Projects</b>		<b>240.1</b>	
<a href="#">HO0197</a>	Poverty Reduction Program focusing on Indigenous peoples and Afro descendants	10.0	
<a href="#">HO0222</a>	Social Protection Program	30.0	
<a href="#">HO0223</a>	Public Finance strengthening support	30.0	
<a href="#">HO0174</a>	Sanitation and Water Investment Complem.	14.0	
<a href="#">HO0192</a>	Credit Global Program	30.0	
<b>Total - B : 5 Projects</b>		<b>114.0</b>	
<b>TOTAL - 2004 : 13 Projects</b>		<b>354.1</b>	

**Total Private Sector 2003 - 2004**      **22.0**

**Total Regular Program 2003 - 2004**      **469.6**

\* Private Sector Project

## POVERTY REDUCTION SUPPORT PROGRAM

(HO-0212)

### EXECUTIVE SUMMARY

<b>Borrower:</b>	Republic of Honduras	
<b>Executing agency:</b>	Secretary of State in the Office of Finance (SEFIN)	
<b>Amount and source:</b>	IDB (FSO):	US\$30 million US\$15 million (first tranche) US\$15 million (second tranche)
<b>Financial terms and conditions:</b>	Amortization period:	40 years
	Grace period:	10 years
	Disbursement period:	2.5 years
	Interest rate:	1% during grace period and 2% thereafter
	Supervision and inspection:	1%
	Credit fee:	0.5%
	Currency:	United States dollar
<b>Objectives:</b>	<p>The purpose of the proposed program is to help Honduras meet the specific social-sector targets within the poverty reduction targets contained in its poverty reduction strategy (PRS). The support provided will be conditional on: (i) verifying systematically the interim targets of the PRS, by promoting the development of planning and monitoring methodologies that link policy and investment decisions to specific progress in reaching the targets set for the social sectors; (ii) monitoring the quantity and quality of public social spending on poverty reduction; and (iii) promoting substantive reform in priority social sectors. These three activities together will bring the country closer to attaining the milestones for the social sector established in the decision point paper, and will provide mechanisms for moving forward toward the HIPC (Heavily Indebted Poor Countries) initiative completion point.</p>	
<b>Description:</b>	<p>The operation is structured as a policy-based loan in the amount of US\$30 million that will be disbursed in two tranches of US\$15 million each. As in the case of other policy-based loans, a policy letter will also be submitted to the Board, in which the government makes a commitment to maintain a macroeconomic</p>	

situation in keeping with the objectives of the operation and outlining the guidelines and general objectives in the areas of poverty reduction and management capacity in the social sectors.

**Coordination with other official development institutions:**

The Bank team met regularly with the group of development agencies working in Honduras and explained the scope of this operation. Specifically, the team maintained constant coordination with the World Bank team preparing the Poverty Reduction Strategy Paper (PRSP) to strengthen the complementarity of the policy measures and promote a shared sector focus (paragraph 1.66).

**The Bank's country and sector strategy:**

The Bank's strategy is to support the government in poverty reduction by promoting higher sustainable growth driven by enhanced competitiveness and higher production capacity on the part of the poor. The strategy focuses on three areas of activity: (i) enhance the competitiveness of productive activities; (ii) increase human capital development; and (iii) consolidate governance. Human capital development is considered a key element in the growth equation and consequently in poverty reduction because it is a decisive factor in enhancing productivity. By promoting the PRS, the proposed program will support the government's efforts to accord priority to investments to support human development and promote changes in management designed to provide more effective backing for the poverty reduction efforts. In addition, the focus on policy reform in education and health will spur improvements in the efficiency of investment in those sectors.

**Environmental and social review:**

No adverse environmental effects are foreseen since most of the activities planned will focus on monitoring the efficiency and effectiveness of social spending and on promoting regulatory standards and rules for education and health. For the component to monitor physical and financial targets of priority programs, the project team has worked closely with the Honduran Social Investment Fund to ensure that protected investments conform to applicable environmental standards. This verification was done by means of a review of reports on the corresponding programs and projects. In the health sector, the new hospital policy will go hand in hand with support for implementing environmental measures to deal with hospital waste. (See paragraphs 2.18 and 2.24 of the proposal.)

**Benefits:**

The main benefits accruing from the program will be the advances made in reducing poverty in Honduras, as measured by progress in attaining the targets for health and education improvements set forth in the PRS. The idea is to create an institutional setting that tends to align performance with the agreed targets. The progress made in reaching the poverty reduction targets will bring the country closer to the HIPC completion point, which would in turn enable it in the

medium term to reduce substantially its external debt and boost economic growth.

**Risks:** The proposed social reforms could encounter resistance from different sectors of society, potentially affecting their political viability. The project team reviewed the viability of the reforms while the program was being prepared and is of the view that the rate of advance proposed is compatible with the government's institutional capacity. The establishment and implementation of a consultative council consisting mainly of representatives of government and civil society will organize debate on a footing where dissent and dispute are structured and conducive to building a consensus and reaching agreement. In addition, the reforms spurred under the program have been part of the PRS content, which has entailed a high degree of consultation and consensus-building with civil society.

**Special contractual clauses:** The funding will be disbursed in two tranches of US\$15 million each, conditional upon fulfillment of the conditions specified in chapter II of the proposal and summed up in Annex I (matrix of conditionalities). The disbursement procedures for sector adjustment loans set out in document GN-2001-2 approved by the Board of Executive Directors will apply.

**Status of conditions precedent for disbursement of the first tranche:** By the date this proposal is considered by the Board of Executive Directors, it is expected that all the conditions precedent for disbursement of the first tranche will have been fulfilled, and the Government of Honduras is taking steps to establish a macroeconomic environment compatible with the program objectives.

**Poverty-targeting and social sector classification:** Since the program beneficiaries are the lowest-income groups in Honduras, including those at high risk, the operation qualifies as a social-equity enhancing project as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). The targets and indicators agreed on for monitoring the program will reflect the performance of actions to measure improvements in social equity. Inasmuch as the operation is a policy-based loan, it does not qualify as a poverty-targeted investment (paragraphs 4.12-4.13).

**Exceptions to Bank policy:** None.

**Procurement:** Not applicable.

## **I. FRAME OF REFERENCE**

### **A. Introduction**

- 1.1 The purpose of the proposed program is to help the Government of Honduras implement a poverty reduction strategy (PRS). The support provided will center on verifying systematically the medium-term targets of the strategy, monitoring the quantity and quality of public social spending on poverty, particularly the PRS's more dynamic programs, and promoting substantive reform in priority social sectors. These three activities will bring the country closer to attaining the milestones for the social sector established in the Decision Point Paper, and will provide mechanisms for moving forward toward the HIPC (heavily indebted poor countries) initiative completion point. If the country can benefit fully from HIPC debt relief, it will be able to achieve the PRS targets, thus alleviating the fiscal situation, with the possibility of setting up mechanisms that would return it to a path of greater economic growth.

### **B. Macroeconomic context**

- 1.2 During the period from 2001 to 2002, Honduras experienced a slowdown in economic activity that has continued into 2003. GDP growth is now at levels similar to the demographic growth rate, leading to a stagnation in per capita income growth.
- 1.3 Although in the wake of Hurricane Mitch Honduras managed to bring its GDP growth rate up to 5.7% in 2000, in 2001 the adverse international environment, with a pronounced drop in the terms of trade (a cumulative rate of 34% during the period 1999-2002), a slowdown in the international economy, and a decline in both public and private investment led to the decrease in the economic growth rate in the above-mentioned two-year period.
- 1.4 In the macroeconomic framework of Honduras, the weakness of public finances has been accentuated. Current public sector savings became negative in 2001, and the deficit worsened in 2002. While the government has taken measures for income and expenditures to correct the situation in 2002 and 2003, pressures from salary increases in the civil service, the deterioration in the financial position of government enterprises, the costs of closing and capitalizing troubled banks, and the support provided to the agricultural sector under the new law to support agricultural producers have made it difficult to restore fiscal discipline.
- 1.5 Although the downward trend in the terms of trade continues—at 6.6% in 2002, similar to the previous year's rate—the deficit in the current account on balance of payments dropped to 2.9% of GDP due to decline in imports and an increase in remittances. Net international reserves increased, but because of the transfer of savings from the telephone company abroad, which helped offset the 33% reduction in loan disbursements to the public sector.

- 1.6 In 2003, the country's external accounts deteriorated further, with a decrease in international reserves by the equivalent of 1.5% of GDP in the first half of the year. The slow growth in exports, an increase in oil prices, and stagnation of loan disbursements to the public sector may explain this performance.
- 1.7 Despite the efforts made by the authorities, there have been delays in reaching an agreement with the IMF, due to the deterioration in the fiscal situation, which has been dragging on since the previous administration left office, when at year-end 2001 there was a significant deviation from the fiscal goals under the current program. This situation had led to a setback in Honduras's reaching the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative, affecting the financing of the poverty reduction strategy. Consequently, poverty reduction strategy spending has been much lower than expected, at 3% of GDP instead of 5% of GDP as planned.
- 1.8 In 2003, Honduras only received US\$5.8 million in total interim debt relief for the remainder of the IDB relief. It is expected to reach the HIPC completion point in 2005, thereby generating additional pressures on public finances, since the country will not receive any debt relief in 2004, but at the same time will have to defray the costs of the poverty reduction strategy.

### **C. The IMF program**

- 1.9 The objectives of the IMF program under the Poverty Reduction and Growth Facility (PRGF) are to bring economic growth up to a range of 4%-4.5% during the period 2004-2006, with inflation similar to that of the country's trading partners, and to reduce poverty in accordance with the goals established in the poverty reduction strategy review. The most important elements of the program are reducing the fiscal deficit, strengthening the financial system, implementing the poverty reduction strategy, and improving governance.
- 1.10 To this end, the program calls for strengthening public finances by increasing tax revenues, gradually reducing the government payroll in line with implementation of the poverty reduction strategy, increasing anti-poverty spending to reach the goals established in the strategy, and streamlining subsidies. At the same time, the program seeks to improve the financial position of government enterprises.
- 1.11 In addition, the program will support strengthening of the financial sector through activities focusing on three pillars: (i) strengthening the legal and prudential framework; (ii) improving bank supervision; and (iii) strengthening the financial position of banks. These activities will receive parallel, coordinated support under World Bank and IDB programs for the sector.
- 1.12 To the same extent, the program being negotiated will support implementation of the poverty reduction strategy through an increase in anti-poverty spending and

promotion of a growth strategy that will favor low-income groups. Moreover, activities will be carried out to modernize the political system, implement the anti-corruption strategy, and strengthen the Office of the Auditor General, among other measures, to enhance program viability.

- 1.13 Through the ongoing national dialogue, the government is in the process of negotiating a fiscal pact that will provide support for the measures contained in the program and open up the fiscal space necessary to implement the poverty reduction strategy. The negotiations with the IMF are based on this foundation, and are expected to conclude in 2003.

#### **D. Poverty in Honduras**

- 1.14 Honduras is the third poorest country in Latin America and the Caribbean, after Haiti and Nicaragua. In 1999, per capita GDP stood at US\$760, one of the lowest in the region, a factor that goes a long way to explaining its low standing on the Human Development Index. In 2001, approximately 63% of households were living below the poverty line, and nearly 45% in extreme poverty. In rural areas, the incidence of poverty is far higher than in urban areas, with extreme poverty afflicting 61% of households.<sup>1</sup>
- 1.15 In spite of the sustained economic growth noted in recent years, the number of households below the poverty line declined by only 9%. During the 1990s, for each percentage rise in per capita GDP was met by a decline of just 0.65% in the incidence of poverty, compared with an average of 0.94 for Latin America as a whole. These data suggest that in Honduras growth accounts for only 40% of the variables affecting poverty over time.<sup>2</sup> One of the factors behind the low rate at which improvements in GDP are reflected in similar improvements in poverty is limited access to productive assets, including land, credit, and secondary and technical education, and inequitable distribution of personal income.<sup>3</sup>
- 1.16 The improvement in economic growth has led in turn to a modest upturn in social spending, which according to official government figures accounted for 45% of total public spending in 2001. The pace of social spending has been circumscribed by GDP growth, declining fiscal revenues, and constraints imposed by the burden of external debt service. In late 1999, the country had an external debt in nominal terms of US\$4.3 billion, or approximately US\$3.3 billion at net present value. Putting this figure in context, it corresponded to 61% of GDP, 142% of exports, and 332% of fiscal revenue in 1999. Following three Paris Club debt restructurings with

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<sup>1</sup> Progress report and update on the Poverty Reduction Strategy for Honduras—draft for final discussion, Government of Honduras, 2003.

<sup>2</sup> HIPC Decision Point Paper. Honduras, World Bank, International Monetary Fund, 2000.

<sup>3</sup> Foster, James and Miguel Székely. Is Economic Growth Good for the Poor? Tracking low incomes using General Means. IDB January 2001.

concessional funding during the 1990s and the post-Hurricane Mitch assistance, Honduras' debt service continues to represent a substantial fiscal burden and a drag on economic growth, severely curbing the revenue available to improve conditions for the poor.

#### **E. The HIPC initiative**

- 1.17 Honduras' unsustainable external debt situation has cleared the way for eligibility for the HIPC initiative fiscal window,<sup>4</sup> whose underlying aim is to achieve a debt to fiscal revenue ratio of 250%. The country reached the decision point<sup>5</sup> in July 2000, at which time it received debt relief with a net present value of US\$738 million, of which US\$182 million corresponded to traditional debt relief mechanisms that had been depleted and US\$556 million to the HIPC initiative.
- 1.18 Honduras will reach the decision point upon successful completion of a number of targets, including (i) an interim poverty reduction strategy, and (ii) a second satisfactory review of the poverty reduction growth facility agreed on with the IMF. When it reaches the HIPC decision point, the country posted an improvement in certain important social indicators, reflecting more effective targeting of spending on primary social services and implementation of an important social safety net for building social infrastructure and targeting assistance to help the most vulnerable groups.
- 1.19 One of the major decisions emanating from the negotiations that led to the decision point agreement was to offer Honduras the possibility of greater debt relief during the period running from the decision point to the completion point. There was also agreement on floating conditions to verify that the completion point had been reached, originally projected to occur in mid-2002, but now expected for early 2005. The general conditions for the completion point are (i) maintaining macroeconomic stability as evidenced by the performance of the PRGF, (ii) successfully implementing the PRS for at least one year, and (iii) implementing a series of social and structural reforms.
- 1.20 The main social reforms are (i) reform of the social security system in a move to broaden the coverage and quality of health services and to ensure the sustainability of the pension system; (ii) strengthening of basic health services targeted to the very poor through the delivery of service packages for at least 100,000 beneficiaries in poor communities; (iii) improvements in the quality of education through more schools with the support of beneficiaries for their administration; and

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<sup>4</sup> The assistance is provided under the fiscal window when the debt to fiscal revenue ratio exceeds 250%. The general window applies when the debt to export ratio exceeds 150%.

<sup>5</sup> The decision point is reached when creditors agree to forgive debt provided that the country fulfills a number of conditions. The completion point is reached when the country has fulfilled the conditions and is approved definitively for debt reduction.



- (iv) improvements in the efficiency and targeting of social safety nets particularly increasing involvement by beneficiaries in selecting and supervising projects administered by the Honduras Social Investment Fund (FHIS).
- 1.21 **Interim debt relief.** Of an estimated sum of US\$738 million in terms of net present value, the country has now received interim debt relief of US\$81.7 million in nominal terms.<sup>6</sup>
- 1.22 For budgetary and financial administration of relief, the Ministry of Finance's budget and public credit departments opened two special accounts with the Central Bank of Honduras (one in dollars and the other in lempiras) for deposits of interim relief. For budgetary records, the HIPC program was opened with financing from line item 29. In each case, periodic reports of source and application of funds are published.
- 1.23 In 2001, HIPC debt relief of US\$27.1 million was released for projects targeting education (46%), health (26%), and housing (25%). For 2002, the allocation and distribution of funding will follow this same pattern, except that more emphasis will be placed on the Family Allowance Program (PRAF),<sup>7</sup> with funds being diverted from housing to make up the shortfall. The government prepared a debt relief program for 2000-2002, which was tied in with the PRS financial plan. This initiative has successfully identified a shortfall of 53.8% between amounts programmed and the funding used for relief such as transfers and budget savings. This imbalance is one of the underlying causes of the PRS financing shortfall.
- 1.24 **The completion point**, originally planned for June 2002, is now expected for early 2005. A review of the general conditions shows that in the macroeconomic context, the country abandoned the PRGF, which was to be in effect until December 2002, and a new PRGF for 2004-2006 is being planned. The poverty reduction strategy has been in effect for one year and the government had prepared a progress report and update, on which consultations were held with broad segments of society. One of the fundamental issues of the review is expected to be the relevance of the financial projections and the extent to which the agreed targets and the planned programs and projects were fulfilled. With respect to reform, it was noted that enactment of legislative reform of social security, broader coverage of health services through a first aid medical package and the increasing participation of the community in selecting and administering FHIS projects.

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<sup>6</sup> Progress Report on social spending on programs and projects linked to the PRS. 2000-2002, SEFIN, July 2002.

<sup>7</sup> PRAF resources are used to finance school and mother child vouchers, food vouchers for the elderly, etc.

## **F. Poverty reduction strategy (PRS)**

- 1.25 In the context of the HIPC, the Honduran government drew up a PFS with the following aims: (i) to achieve faster economic growth that is sustainable and equitable; (ii) to develop human capital, mainly in health and education; (iii) to reduce poverty in low-income rural and urban areas; and (iv) to strengthen social protection for groups in extreme poverty.
- 1.26 The various policy measures, programs, and projects that will make the PRS viable are based on the following strategic guidelines: (i) faster economic growth that is sustainable and equitable, (ii) poverty reduction in rural areas, (iii) poverty reduction in urban areas, (iv) investment in human capital, (v) strengthening of social protection of specific groups, and (vi) guaranteeing the sustainability of the strategy.<sup>8</sup>
- 1.27 Monitoring the progress of the strategic guidelines for investment in human capital will be done by review of a group of targets set for 2015: (i) to reduce the incidence of poverty and extreme poverty by 24%, (ii) to double net coverage of preschool education for children under 5, (iii) to achieve 95% net coverage in the first two cycles of basic education, (iv) to achieve 70% net coverage in the third cycle of basic education, (v) to achieve 50% completion of secondary education for new labor market participants, (vi) to halve infant and maternal mortality, (vii) to achieve 95% access to drinking water and sanitation, (viii) to obtain gender parity and improve the ranking in the human development index by 20% in gender-related areas, and (ix) to implement a sustainable development strategy. In addition, short- and medium-term goals will be set as annual targets for 2000-2005. These targets, although ambitious, are considered attainable in the context of the policy reforms agreed on and based on successful implementation of the strategy programs.
- 1.28 The review of the content and scope of the PRS has brought out: (i) the need to develop alternative financial scenarios and adjust priorities in the event that external financial assistance does not materialize as planned, and (ii) to speed up the design and implementation of mechanisms for monitoring PRS spending, in order to enhance the efficiency and targeting of public social spending.<sup>9</sup>
- 1.29 **PRS projects and financing.** The strategic guidelines and fulfillment of the PRS targets will be carried out by means of a series of programs and projects that are new or under way. Such programs and projects have been accorded priority and costed as a whole when the strategy was discussed. When priorities were initially accorded, 29% of the financing was allocated to projects for investment in human capital, and 25% for urban poverty reduction projects as the main investment categories.

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<sup>8</sup> The Poverty Reduction Strategy Paper for Honduras, Government of Honduras, 2001.

<sup>9</sup> Poverty Reduction Strategy Paper, Joint Staff Assessment, IDA & IMF, 2001.

- 1.30 The total cost of programs and projects that are new or in progress is US\$2,666 billion over the 15-year period considered for the PRS. Of this amount, US\$1,896 billion is for new projects without guaranteed financing. The Government of Honduras estimated that the financing for new projects would require funding of nearly US\$200 million annually, drawn mainly on HIPC debt relief and traditional sources of relief administered by the Paris Club. A review of the figures for 2002 shows that the gap between financial programming and available resources is 70%, which means that only US\$30.6 million of the US\$173.5 million originally programmed is available. Projections of additional revenue coming in the medium term from debt relief will not be enough to meet the needs of the PRS, thus creating a serious imbalance between planned projects and costs and potential funding. With respect to costs, to bring aspirations into line with available funding, it will clearly be necessary to ensure that projects under way are more effective and to make adjustments to the criteria and priorities of new programs and projects.
- 1.31 One finding of this analysis is that for the PRS to be realistic and to be effective in its impact on poverty, both specific targets and careful prioritization of investment programs is needed, selecting those with the greatest impact on poverty reduction. The traditional institutional mechanism for making investment decisions with public resources usually does not take poverty reduction as one of its determining factors. In decision-making, the economic authorities accord priority to a country's macroeconomic stability whereas in the social sectors the authorities often predicate their decisions on day-to-day emergency decisions and random negotiations on numerous projects and their respective financing agencies.<sup>10</sup> To this end, a specific objective of the proposed program is to spend public resources more effectively and to make adjustments to the mechanisms for selection and ongoing evaluation of PRS priority programs.
- 1.32 **Public social spending (PSS) under the PRS.** Under the PRS, the Government of Honduras agreed to gradually increase the proportion of overall public spending on the social sectors from 43.7% in 2001 to 52% by 2005. PSS is defined in the strategy as aggregate investment on (i) human capital (education, health, and water and sanitation); (ii) social safety nets (contributions to social security institutions, social transfers payments, and subsidies and grants); (iii) housing; and (iv) support for the rural sector.
- 1.33 Of the total amount set aside for social spending, 74% will go on investment on human capital, 22% on social safety nets, and 4% on support for the rural sector. In human capital investment, priority will be given to education, which absorb 62.4% of the funding and health receiving 37.6%. A further breakdown shows that

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<sup>10</sup> The Mesa Redonda de la Cooperación Externa en Educación [Round Table for External Cooperation on Education] (MERECE) has prepared a matrix of education programs and projects with 57 records. These are financed by a wide number of donors and multilateral agencies.

investment in primary and secondary education accounts for 74.5% of public spending on education, with investment in post-secondary education taking 25.5%.

- 1.34 A recent study of the quantitative and qualitative nature of PSS in Honduras and its effectiveness examined the breakdown of spending and segregated capital expenditure and recurrent expenses, which were in turn broken down into payroll and nonpayroll expenses. As shown in the table below, significant differences exist between the health and education sectors.

**Table I.1**  
**Public spending on education and health**  
**(2002)\***

Item	Amount	
	US\$000	%
<b>A. Education</b>		
Payroll	187,000	98.5
Nonpayroll:		
Recurrent	2,300	1.2
Capital	550	0.3
<b>Total education</b>	<b>189,850</b>	<b>100</b>
<b>B. Health</b>		
Payroll	64,600	79
Nonpayroll:		
Recurrent	16,300	20
Capital	950	1
<b>Total health</b>	<b>71,850</b>	<b>100</b>

\* Not included are transfers or debt service, which do not contribute to the analysis and whose impact is minimal. An exchange rate of US\$1 = 16.5 lempiras is assumed. Data are spending as of August 2002.

- 1.35 Significant differences are evident between the sectors in terms of the weighting of payroll expenses. In the case of education, payroll accounts for 98.5% compared with a scant 3% for recurrent non-payroll expenses and capital expenditure as a result of the teaching legislation. In the health sector, the situation is quite different since the ratio is nearly 80 to 20 between these two groups of expenses. This preponderance of wages and salaries in the education sector and its inflexibility stands in the way of efforts to increase spending on learning materials, teacher training and on classroom construction, rehabilitation, and maintenance. A review of the trend over the last two years shows that payroll rose by nearly one percent a year, without any increase in the teaching staff as a result. This situation gradually chokes capacity to create the new slots that would be necessary to meet the goals of expanding coverage targeted by the PRS.

- 1.36 In view of the limited resources available and the challenges the country faces in terms of education, quality and coverage, the government has assigned priority to taking measures to improve the distribution of teachers, so as to reduce the number assigned to administrative duties and review and clear the payroll of irregularities that are draining the system of valuable resources. An effort has been made to support the measures with greater teacher supervision, with special attention to teacher attendance.
- 1.37 Most of the initiatives designed to promote policy measures to restructure the role played by the Ministry of Education, to redefine the profiles of officials in deconcentrated areas, and to develop vehicles and methods for monitoring teaching performance, will entail effective execution of the non-wage side of the budget. Clearly such an effort cannot be obtained without concurrently curbing increases in payroll, which is part of the new IMF PRGF program. In this connection, rather than eliminate programs and projects, efforts to increase efficiency will need to focus on controlling salaries and effectively implementing non-wage programs that have a greater impact on education targets and have a more direct influence on the pace at which economic growth translates into poverty reduction.

## **G. Monitoring and evaluation of PRS**

### **1. Mechanisms**

- 1.38 **SIERP.** The Bank drew on the proceeds of the Japan Fund (ATN/JO-7507-HO) to support the design and implementation of the PRS indicator monitoring system (SIERP). The system, once fully implemented, will operate under the coordination of the Technical Support Unit in the Ministry of the President's Office. The SIERP has been assigned functions of coordination, systematization and dissemination of data and reports relating to progress with the PRS and carries them out with substantive data on management performance from the major ministries and other agencies in the social sectors. The final SIERP will be a combination of the original PRS benchmark system and the information system for performance monitoring (SINEG). As a system, the SIERP does not generate any primary data but rather compiles indicators produced by participating institutions; it relies on the National Statistics Bureau to conduct specific surveys to formulate indicators for areas in which primary institutional data are insufficient. The SIERP contains the indicators as well as the source of data, responsibility for collection and processing, linkages with budgetary information, and the reporting system for monitoring.
- 1.39 The Technical Support Unit (UNAT) will basically coordinate four different organizations, which overall contribute SIERP information: (i) the National Statistics Bureau (INE), which will provide information on the general rate of advance and PRS sector indicators; (ii) the Ministry of Finance (SEFIN) and the Ministry of International Cooperation—by way of the Integrated Financial Administration System (SIAFI) and the Integrated Public Investment Monitoring

System (SISPU)—will furnish information on the physical and financial advance of PRS projects; and (iii) the Central Bank with macroeconomic information supplemented with information on the fiscal performance of SEFIN. The UNAT will consolidate the information and monitor fulfillment of PRS policy and management actions.

- 1.40 The SIERP has produced a list of interim indicators that target the ultimate PRS goals. The proposed program will move ahead with the process through an arrangement with the Government of Honduras on a basic list of interim indicators from the menu and establishment of annual targets for a period of five years so that the Government of Honduras's performance in meeting the targets will be the factor determining disbursements under the program.
- 1.41 For instance, the institutional coverage of births and prenatal care are considered interim indicators linked to the overall target of reducing maternal mortality. In the case of education, the overall target of doubling net coverage in preschool for five-year-olds may be approximated through interim indicators, such as the number of children enrolled in preschool as measured by final enrollment data.
- 1.42 **Financial and budgetary monitoring.** In addition to monitoring the social targets, it has also become essential to fine-tune the financial monitoring of the PRS, from the time the budget is formulated. The government made considerable headway in moving forward with financial and budgetary monitoring of the PRS with the passage of the 2002 and 2003 Budget Acts with three special features: (i) the general provisions call for approval of the budgets of deconcentrated and decentralized institutions that carry out programs and projects coming under the PRS before the transfer of resources to finance such projects; (ii) the same general provisions prohibit the use of global allocations in the segregated budgets of central, deconcentrated, and decentralized government institutions; and (iii) a PRS consolidated budget government document was approved as an annex, showing the program structures broken down to the minimum target spending level, to which the corresponding PRS budgetary credit were allocated.
- 1.43 An additional step to consolidating PRS information is the design and testing of the Public Investment System Integrated Programs and Projects Bank (BIP-SISPU). The design and testing of a pilot experience was carried out in recent months and was part of the matrix of conditions for disbursement of the second social sector tranche now in progress. This system will make it possible to monitor on an ongoing basis the physical and financial rate of advance of PRS programs and projects.
- 1.44 One component of consolidation of long-term budgetary programming is the multiyear budget. Along these lines, the Honduran government has introduced to Congress a **multiyear financial programming** proposal in the form of a financing investment savings account for 2004-2007. Although the national congress is

authorized to approve only the annual budget for 2003, this medium-term programming exercise is expected to produce an update of the spending targets under the PRS and a prioritization of programs and projects consistent with the actual funding available through debt relief and tax collection. The government has amended the financial management bill, currently being discussed in the National Congress, to establish the legal foundation for multiyear budgeting, define its contents, effective dates, the government agencies it will be implemented in, the system for its approval, review, and amendment, and a phase-in system.

## **2. Institutional considerations**

- 1.45 **The Consultative Council.** A consultative council was set as part of the PRS. The government and civil society are equally represented on this council. The council consults with the social cabinet on matters related to the identification, eligibility, and prioritization of programs and projects. It will also make recommendations on ways to improve PRS management, monitoring, participation by civil society, and the release of information. The members of the council have already been sworn in and the Operating Regulations have been published in the official gazette.
- 1.46 **Poverty Reduction Fund (PRF).** Until now the debt relief funding has been administered in two ways: (i) reimbursements received from the World Bank and the IMF were transferred to a special account with the Central Bank; and (ii) the budgetary savings accruing from the relief received from the IDB and the Central American Bank for Economic Integration (CABEI) were treated as transfers with a debit to the accounts of the Revenue Department and a credit of the HIPC funding to the special account with Central Bank; these funds were budgeted and charged to line item 29 of the national budget. In 2002, legislation was enacted<sup>11</sup> to set up the PRF as a financial instrument for determining the source and application of funds for the PRS. This law will be in force for a minimum of 15 years. The PRF is administered by SEFIN under guidelines established by the social-sector authorities working closely with the Consultative Council. SEFIN entered into an agreement with the Central Bank to cover investment of liquid resources in the PRF not being used for projects approved. The PRF Operating Regulations were published in the official gazette and have been in effect since September 2002. The proceeds of the PRF consist of (i) the entire annual amount of the relief in the form of the reduction in external debt service under the HIPC and other amounts forgiven; (ii) all of the resources granted to Honduras by other nations and international organizations to assist with the PRS; and (iii) other resources received by the government from special sources.

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<sup>11</sup> Pursuant to Decree 70-20-02 of 30 April 2002.

## **H. Performance and challenge to the social sectors**

- 1.47 In addition to the factors relating to spending efficiency, problems associated with the minimal impact that economic growth has had on poverty reduction have been linked to limited access to equity capital. In this regard, as a supplement to establishing and monitoring the PRS annual targets and prioritizing programs and projects, it will also be necessary to introduce reforms in the administration of institutions responsible for these initiatives and to modify how spending is structured and targeted. The following sections describe the most critical management problems identified in the social sectors.

### **1. Health**

- 1.48 In the area of **health**, overall spending amounted to 6.2% of GDP, just above the average for the region. This effort to maintain spending at a proportionately high level went hand in hand with improvements in the delivery of services in the 1990s. However, inequities persist in service access in the form of low coverage and limited government capacity owing to the following management problems in the sector.

#### **a. Performance of health personnel**

- 1.49 With respect to the low coverage, the absence of supervision at workstations means that more than 10% of doctors do not practice in the places where they were originally assigned and that absenteeism is 30%. These problems combined with the increasing personnel costs which make it difficult to add new staff results in low coverage and utilization of health services.

#### **b. Public and private complementarity**

- 1.50 One further matter has to do with legal and organizational impediments in the Ministry of Health in outsourcing services, which limits its capacity to expand coverage to places where services are few or lacking altogether. Efforts to outsource health services have until now been supported with external financing under contractual conditions under agreements with international agencies.

#### **c. HIV/AIDS epidemic**

- 1.51 Honduras is also suffering from a rapidly increasing number of cases of human immune deficiency virus (HIV) infection and acquired immune deficiency syndrome (AIDS). In fact, one half of all AIDS cases in Central America are found in Honduras and the epidemic is reported to have become so widespread to affect nearly 5% of the general population. Various epidemiological, social, and economic factors make it difficult to control the disease in the country. Also, the same structural factors that characterize poverty in the country account for the spread and transmission of the disease. In particular, the major factors include low levels of



education, limited access to health services, and malnutrition. The country has received grant funds from the Global Fund to combat HIV/AIDS, dengue, and malaria and is implementing a comprehensive program to control these diseases.

#### **d. The role of hospitals**

- 1.52 It is important to note the poor productivity of hospitals which is partly attributable to problems of human resources administration as well as to the excessive centralization in the formulation and execution of operating budgets. The Ministry of Health has instituted a new hospital policy designed, among other things, to promote the delegation of administrative functions to hospitals to improve their flexibility in decision-making. It has also made changes in the budgetary framework to expand hospital authority in local financial administration. Although hospitals have a very low occupancy rate, they account for more than 60% of the Ministry's spending, of which a rising 47% goes on wages and salaries. One reason for the increase in prenatal and infant mortality is that hospital care is not very effective. Limited access to prenatal care and the incidence of infectious diseases, the underlying cause in the past, is now eclipsed by shortcomings in basic mother child hospital care.

#### **e. Health sector fragmentation**

- 1.53 The health sector involves multiple aid agencies, trends, and interests. Although they all seek improvements in public health, they lack conceptual and operational coherence usually predisposes it to duplication of effort and inefficiency in the use of resources. The Government of Honduras has decided that to remedy this situation it will propose a SWAP<sup>12</sup> to the aid agencies. The purpose of the SWAP is to administer the sector and external aid through programs rather than projects. The programs will have a long-term strategic vision, which in the case of Honduras will be supported in the Strategic Plan for the Health Sector through 2021.<sup>13</sup> The financing for this initiative will be reflected in the budget prepared in 2004 that will provide the legal foundations and mechanisms for the Ministry of Health to administer the budget for the SWAP.

### **2. Education**

- 1.54 **Education** efficiency indicators are low although spending as a percentage of GDP<sup>14</sup> (4.9%) is more or less in line with the average for Latin America (4.6%). As noted earlier, spending on education is beset with serious problems involving

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<sup>12</sup> SWAP: sector-wide approach

<sup>13</sup> The plan was prepared after broad-based consultation and was recently released to the public by the Ministry.

<sup>14</sup> In some analyses, the implication is that the GDP in Honduras is undervalued, which would make some percentages of spending that seem appropriate to be truly inadequate or below the average for the region.

targeting and efficiency due in part to the inflexible nature of the Teachers Act and to the excessive burden of current expenses. The high proportion of teachers outside the mainstream—more than 40% of the total—is indicative of these shortcomings and goes a long way to explaining the problems of quality. Four major weaknesses have been detected in education administration.

**a. Organization and regulation**

- 1.55 In the process of deconcentrating administration, the part played by the departmental and district offices has not yet been clearly outlined nor has the role of their officials. This has led to low effectiveness in the work by these offices and in school monitoring and supervision and teacher performance monitoring. Furthermore, a lack of regulation governing the operation of schools and parent associations make community participation in school administration difficult. The decentralization process launched in 1996 was clear acknowledgement of the administrative problems as well as a serious attempt to resolve them, by decentralizing responsibilities to the local level so as to give communities a stronger say in the quantity and quality of public goods and their options for voting and also to ensure that the system was administered smoothly at all levels. However, the process was only partly completed, without achieving reorganization of the information system and its flow or a clear idea of the role of the departmental and district offices and the role of their officials.

**b. Coverage**

- 1.56 Honduras finds itself in the middle as far as preschool and primary school enrollment in Central America is concerned, secondary school coverage is among the lowest in the region. The country is therefore committed to meeting some ambitious targets of expanding coverage by at least 60,000 new slots per year. To achieve this goal, the government plans to take steps to improve the internal efficiency of the system, expand private-sector participation in service delivery, and allow more flexibility in the types of education available, particularly at the secondary level. The success of these strategies will be contingent on a serious internal reorganization effort within the sector. Such an effort would need to eliminate current inefficiencies in resource allocation, focus resources on areas with higher unmet needs indexes, and establish mechanisms and incentives for participation by the private sector and NGOs in the supply of services.

**c. Supervision of teacher performance**

- 1.57 The present system does not guarantee something as fundamental as assistance for teachers in school. Available estimates<sup>15</sup> suggest that effective classroom time on the part of teachers ranges from 100 to 110 days a year and from three to four hours

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<sup>15</sup> There is no reliable established system to provide information of this kind.

a day. These figures are over 50% below the average in developed countries. This problem is linked to the lack of a system of administrative and academic supervision and to the absence of social control. The Ministry does not yet have an updated database that reflects the status of teaching staff or mechanisms for discounting salaries for days not worked. This led to a loss of US\$90 million during the general teachers strike of 2001. Hence it is necessary to improve the mechanisms for monitoring and implementing social control so that they can be combined to inform decision makers of the actual number of classroom days and to enable them to take administrative measures that will ensure an increase in effective classroom time.

#### **d. Quality**

- 1.58 The poor quality of education at all levels of the system has an adverse impact on student retention and promotion, contributing to the system's low internal efficiency. One third of all students in grades one through six are repeaters, and on average have repeated twice, especially in marginal urban areas. According to estimates by Schiefelbein (2001), the additional cost of serving repeaters in the primary grades is approximately US\$63 million per year. Data from 1977 from the Education Quality Measurement Unit (UMCE) indicate that the levels of learning in grades two through six for Spanish and mathematics are below the 50% average for basic achievement as specified by the Ministry of Education. Preliminary results from UMCE testing in middle school point to similar problems. Raising system quality calls for action to: (i) improve teacher training; (ii) equip schools with proper educational materials and textbooks; and (iii) guarantee compliance with stipulated classroom hours. In addition, periodic testing of educational achievement is considered crucial in order to focus actions to improve quality on the neediest areas.
- 1.59 The reforms in education and health could encounter resistance from groups with an interest in maintaining the status quo, including teachers and staff that stand to benefit from the Teaching Act. The government has repeatedly had to step in to handle teachers' strikes that sometimes go on for a number of weeks. Public opinion, and particularly the views of heads of households, have acted to exert pressure in disapproving of salary increases without a clear undertaking in return for improvements in education quality.

#### **I. The Bank's strategy for the country and the sector**

- 1.60 The Bank's strategy is designed to support the government in reducing poverty by promoting greater sustainable growth led by increased competitiveness and productive capacity on the part of the poor. The strategic areas on which the Bank's action will focus are: (i) boosting the competitiveness of productive activities; (ii) increasing the development of human capital; and (iii) consolidating governance. The strategy assigns human capital development a central place in the growth

equation and consequently in poverty reduction since it is a critical factor in boosting productivity. By promoting the PRS, the present program supports the government's efforts to accord priority to investments in support of human capital development and management changes designed to provide more effective support for poverty reduction efforts. In addition, the focus on policy reform in education and health will spur improvements in the efficiency of investment in those sectors.

## J. The Bank's experience and lessons learned

1.61 The Bank has granted investment loans to help the government set up an important social safety net through assistance for PRAF and the FHIS. Recent assessments of the major social safety net programs have found that they are targeted efficiently but that because of tax restrictions the PRAF is only able to reach a small percentage of the poorest families. In the 1990s, the FHIS made a significant contribution to reducing basic unmet needs of poor families and the PRAF in its area of impact raised attendance school centers and clinics for the target population.

1.62 Table I.2 presents two sector operations that the Bank has granted to the Honduran government that have to do with the present program. The transition and social protection program (1999) established the social sector authorities to provide advisory assistance to the President of the Republic in formulating social policies and in coordinating institutional initiatives to implement sector policies. One lesson learned from this operation is that coordinating the efforts of officials with decision-making power is important but not in itself sufficient. Also needed is the technical arm of the cabinet to coordinate the technical aspects of the respective management evaluation and planning units (UPEG). This was achieved with the

**Table I.2**  
**Fast disbursing loans for the rural sector in Honduras**

1999: "Social protection and transition program" protected social spending during the transition to the HIPC initiative. It helped prepare the PRS with studies, the establishment of ministries for the social sectors, and strengthening for its technical arm (UNAT). The components of the program were:

- Protection of priority programs: fulfillment of the financial and physical targets in specific projects and programs for education, health, and social assistance.
- Improvements in management capacity: drafted the strategies for implementing efficiency, reformulated two operations to put a greater focus on management enhancement.
- Policy framework: Social Cabinet was created to hasten the formulation and implementation of social policies.

2001: "Transformation of the institutional framework and creation of instruments for implementing the PRS" now under way. The components of this program are:

- Establishment of an institutional and instrumental framework for implementing the PRS. Technical support was given to the Social Cabinet, a system was prepared for monitoring the PRS indicators, and a system was developed to disseminate it.
- Financial instruments for the PRS: the Poverty Reduction Fund and its regulations were created and work was done on improving the transparency of budgetary management to guarantee monitoring from point of origin to destination of resources, thus eliminating the use of global allocations.
- Formal establishment of public participation: the consultative council was created and regulated for the PRS.

following sector, which established an interagency technical team coordinated by the technical support unit, which reports to the Ministry of the President Office.

- 1.63 The 1999 sector program also showed that appropriate monitoring could lead to significant improvements in the projects of line ministries and decentralized public bodies. Hence, SEFIN initiated regular monitoring of annual work programs under that sector operation, monitoring not only budgetary matters (as had been done in the past) but extending monitoring to cover progress made towards attaining physical targets under the annual work programs. Another lesson learned is that in a setting of fiscal austerity innovative social safety net programs prove to be effective. An outcome of the sector program is that all projects received timely counterpart funding and in some cases even more since SEFIN increased its support in order to facilitate implementation of the programs.
- 1.64 The first tranche of the sector loan for reform of the institutional framework and establishment of instruments for implementation of the PRS (2001) has been disbursed and the second and third tranches are ready for disbursement, which is slated for December 2003. The monitoring of the matrix of conditions shows that the conditions for developing instruments for monitoring the PRS have been fulfilled and all that remains to be done is for the government to inform the Bank on the country's present macroeconomic situation. Table I.3 summarizes the objectives of each subcomponent and the corresponding conditions. A lesson learned from the 2001 sector operation is that developing instruments to monitor the financial aspects of an operation from budgetary formulation to the SIAFI phase provides transparency in the use of PRS funds and an incentive for planning and prioritizing the projects of Ministries and other government agencies. Expanding these systems to capture the financial year up to its most minute detail is therefore a relevant aspiration.

**Table I.3**  
**Conditions for the 2001 sector loan**

<b>I. Establishment of institutional and instrumental framework for implementing the PRS</b>	
Create a technical agency with multisector membership to handle the cross cutting nature of the functions falling to the Social Cabinet.	<ul style="list-style-type: none"> <li>(i) The interagency technical team must be set up and its operating manual approved.</li> <li>(ii) The system for disseminating the PRS to the public must be functioning.</li> </ul>
Design and implement a mechanism for monitoring the indicators agreed on under the PRS.	<ul style="list-style-type: none"> <li>(i) The final design of the SIERP must be submitted and agreed on with the sector agencies, civil society, and the participating bodies.</li> <li>(ii) Presentation of a plan for monitoring the PRS indicators approved by the Social Cabinet, that includes sources, individuals responsible, and frequency of data collection.</li> <li>(iii) Final design of the BIP-SISPU information system must be submitted and its operation tested by means of a pilot experience.</li> </ul>
<b>II. PRS financial instruments</b>	
Create a financial facility that monitors in a transparent manner the raising, channeling, and use of financial resources employed in PRS programs and projects.	<ul style="list-style-type: none"> <li>(i) Decree establishing the Poverty Reduction Fund (PRF) must be in force.</li> <li>(ii) The PRF Operating Regulations must be in force.</li> </ul>
Strengthen the budget as a tool for monitoring and control of PRS resources.	<ul style="list-style-type: none"> <li>(i) General Provisions of the National Revenue and Expenditure Budget must contain standards requiring the approval of the 2002 budgets prior to transfer of resources to finance PRS programs and projects.</li> <li>(ii) The budgets for the present financial year of deconcentrated and decentralized bodies must have been approved to implement PRS programs.</li> <li>(iii) Quarterly publication of progress made on reaching physical and financial targets of the PRS.</li> </ul>
<b>III. Formal establishment of public participation</b>	
Establish an instrument for linkages between the Honduran government and civil society that acts as a mechanism for consultation and monitoring of the PRS.	<ul style="list-style-type: none"> <li>(i) Executive Decree creating the Consultative Council must be in force.</li> <li>(ii) Operating Regulations of the Consultative Council must be in force.</li> <li>(iii) PRS Consultative Council must be functioning.</li> </ul>

- 1.65 The 2001 social sector program deals with all institutional aspects and the instruments for the functioning of the PRS so that the program proposed in the present report is supplemented with the previous sector operation with its focus on implementation and monitoring of targets for the next five years, monitoring of quantity and quality of the PSS geared to poverty reduction, efficiency and

relevance of ministry priority projects, and problems with implementation by institutions involved in PRS.

**K. Coordination with other official development agencies**

- 1.66 The Bank team met constantly with other cooperation agencies working in Honduras, and outlined the scope of this operation. More specifically, the team coordinated constantly with the Bank team preparing the poverty reduction support program (PRSP) to ensure the complementarity of policy measures and a shared sector approach.

**L. Justification of the program**

- 1.67 As part of the HIPC process, the government has prepared a broad PRS that contains ambitious and comprehensive long-term targets. Implementing this strategy will require policy changes that address the administrative weaknesses identified and accord priority to projects and programs that are more directly and effectively related to accomplishing the targets. Also, monitoring a group of interim PRS indicators and the respective annual targets and the linkage of these targets to the matrix of conditions of the proposed program bridges the gap between policy measures and sector performance. As part of the fiscal constraints that now exist and given the growing shortfall gap between what has been planned and the resources available to finance the PRS, the management and targeting measures assume particular importance, especially if tied to the reforms agreed on for reaching the HIPC completion point.
- 1.68 Any delay in reaching the completion point will postpone full debt relief under HIPC conditions, widens the PRS financing gap, and hampers progress in attaining the poverty reduction targets. The country's efforts are centering on resolving the fiscal situation and restoring the country to the path of macroeconomic stability as well as to make headway in consolidating social sector reform. In this same vein, the program provides support for reaching the completion point and speeds up access to full debt relief by supporting efforts to achieve macroeconomic stability and promoting the implementation of reform and management of social spending.
- 1.69 The conditions for reform included in the present operation will offer a systematic monitoring plan that furnishes the government with information on the relevance and effectiveness of project under way in the short and medium term. Such information will make it possible to make timely adjustments to implementing the PRS and planning new projects based on analytical results, helping the government to develop incentives for officially establishing and consolidating planning, monitoring, and evaluation practices.

## **II. THE PROGRAM**

### **A. Objective**

- 2.1 The objective of the program is to make progress towards attaining specific social-sector targets within the poverty reduction targets contained in Honduras's PRS. Specifically, the program seeks to link strategic and financial decisions made at the highest levels of government with a commitment to reach specific targets in education and health, which could ultimately have an impact on poverty reduction. This entails: (i) the government's adoption of annual interim progress targets in the social sectors over a five-year horizon in order to monitor the progress made in implementing the PRS; (ii) utilizing social public spending more efficiently and refining the mechanisms for selecting and evaluating on an ongoing basis PRS priority programs; and (iii) resolving key management problems that render social services delivery inefficient and jeopardize the possibility of attaining the targets by means of a series of policy reforms.

### **B. Structure of the program**

- 2.2 The funding will be disbursed in two tranches of US\$15 million each under the modality of a policy reform program. The purpose of the first tranche will be essentially to spur policy reforms and the second combines a consolidation of reforms with the monitoring of country performance in attaining the interim targets in the social sectors linked over the long term to the ultimate goals of the PRS. The basis of the program is a policy letter describing in detail the country's present economic situation, the government's guidelines for poverty reduction and social sector management capacity and its general objectives in these areas. The final version of the letter appears in Annex III and is an integral part of the proposal to be submitted to the Bank's Board of Executive Directors. Disbursement of the proceeds of each tranche will be conditional on the borrower maintaining, to the Bank's satisfaction, a macroeconomic environment that is consistent with the objectives of the program, and prepares and implements the agreed policies, as outlined in the components and policy matrix in Annex I. The conditions precedent to disbursement of the first tranche are expected to be fulfilled before the proposal goes to the Board for consideration.
- 2.3 **Expected accomplishments of the program.** Upon completion of the program, the country will produce planning and monitoring mechanisms to link its sector policy initiatives to the successful attainment of annual interim targets that track the progress made towards global poverty-reduction targets. By the end of the program, the government will have improved the targeting and amount of social public spending in priority areas and will provide financial protection to social programs closely linked to the initial PRS targets and to fulfillment of the completion point conditions of the HIPC initiative. The government will supplement earlier



methodologies with improvements in the administration of the ministries that will assist with the decentralization of service delivery and supervision, rationalization of staff headcounts, and extended coverage of services with support from the private sector.

- 2.4 **Description of the components.** The program is divided into three components: (i) promotion of performance-based management, which includes linking attainment of targets to program disbursements; (ii) improving efficiency and effectiveness in social spending; and (iii) improving administration in the Ministries of Education and Health for PRS implementation.

### **1. Performance-based management**

- 2.5 **Objective.** The purpose of this component is to assist the government in developing planning and monitoring methodologies that link policy and investment decisions with specific progress targets in the social sectors to facilitate poverty reduction. An approach such as this makes it possible to promote performance-based management in these institutions.

- 2.6 **Line of action.** The UNAT, with support from the SIERP, (i) will select a given number of interim indicators and their corresponding targets with characteristics that are readily identifiable and the movement of which is indicative of the progress being made to attain the overall targets for 2015 associated with the implementation of the PRS. It will also establish a computational methodology and a source of information for efficiently obtaining these indicators. A technical notebook containing all of the relevant information will be part of the technical supporting documentation contained in this report. Annex II presents the interim indicators by sector, the base line, and the annual targets for the next four years.

- 2.7 As a condition precedent to disbursement of the **first tranche**, the following must be fulfilled to the Bank's satisfaction:

- (i) Selection of interim and output indicators associated with global PRS targets and, for each one, its definition, the establishment of a base line, the source of information, and the annual targets for four years.

- 2.8 As conditions precedent to disbursement of the **second tranche**, the following must be fulfilled to the Bank's satisfaction:

- (i) A progress report of the interim indicators for monitoring the PRS showing that the annual targets for 2004 have been substantially fulfilled; and
- (ii) Evidence that the SIERP has been established, is generating reports to monitor the indicators and targets, and shows the outcomes, in accordance with the design.

## 2. Spending efficiency and effectiveness

- 2.9 The objectives of this component are to strengthen the financial administration and follow-up of projects to generate long-term strategic budget planning appropriate to financing programs with a sector approach rather than specific projects. This will also facilitate monitoring the physical and financial targets of a series of programs and projects presently under way that are closely linked to accomplishment of the PRS targets. In the medium term, mechanisms for formally establishing an ongoing process of prioritizing and monitoring projects to avoid diversions from the PRS objectives are expected to be in place.

### a. Public social spending prioritization subcomponent

- 2.10 **Objective.** The purpose of this subcomponent is to support setting priorities for public social spending by developing the legal framework and implementation of multiyear budgets and budget references to develop SWAP-type sector approaches. These measures underpin support for efforts to reach the interim PRS targets.
- 2.11 **Lines of action.** Under this subcomponent, and as crosscutting support for PRS programming and financial planning, the government has introduced to Congress the 2004-2007 multiyear financial program. In late 2003 the government has requested from Congress inclusion in draft legislation on the financial administration system of a legal framework for multiyear budgeting and a gradual implementation schedule. In parallel, the government has developed an action plan to place into budgetary effect the SWAP-type sector approach (see Annex I, policy matrix).
- 2.12 As conditions precedent to disbursement of the **first tranche**, the following must be fulfilled to the Bank's satisfaction:
- (i) Evidence that the government has requested Congress to include the legal framework for multiyear budgeting in draft legislation on financial administration;
  - (ii) Presentation to the Bank's satisfaction of an action plan to place the sector approach into budgetary effect in at least two of the social sectors associated with the ERP;
  - (iii) Presentation to the Congress, for its consideration, of the multiyear financial program in the form of a savings account for investment financing for the period 2004-2007.
- 2.13 As conditions precedent to disbursement of the **second tranche**, the following must be fulfilled to the Bank's satisfaction:

- (i) Presentation to the Secretariat of Congress, for the latter's consideration, of the multiyear financial program in the form of a savings account for investment financing for the period 2005-2008.
- (ii) Evidence that the budgetary action plan has been implemented satisfactorily in at least two of the social sectors referred to in subsection (ii) of the first tranche.

**b. Subcomponent for fulfillment of physical and financial indicators**

2.14 **Objective.** The purpose of this subcomponent is reach agreement on the physical and financial targets linked to priority programs for moving ahead with the PRS under the institutions in the social safety net (health, education, FHIS, and PRAF), that are financed with nationally sourced funds, loans, and grants. Monitoring will be based on the BIP-SISPU data. The audited financial statements of programs and projects will also be used. The following table shows programs accorded priority and the expenses that will be monitored.

**Table II.1**  
**Priority programs and amounts to be monitored**

<b>Sector</b>	<b>Amount (US\$000)</b>
<b>HEALTH</b>	<b>7,100</b>
1. Health services reorganization program	6,100
2. Health sector reform program	1,000
<b>EDUCATION</b>	<b>20,000</b>
1. EDUCATODOS	2,280
2. Literacy and basic education program for young people and adults	1,100
3. Academic excellence study grant program	2,000
4. National education transformation program	3,750
5. Community education program (PROHECO)	10,860
<b>PRAF</b>	<b>22,300</b>
1. School voucher program, grades 1-4	2,100
2. Mother child voucher program	1,700
3. Senior citizens assistance program	1,000
4. Integrated development program for women	2,200
5. Integrated family development program	2,000
6. PRAF II	13,300
<b>FHIS</b>	<b>22,500</b>
1. Water and sanitation pilot program	2,000
2. Project cycle delegation program	2,500
3. Infrastructure services program	18,000
<b>TOTAL</b>	<b>71,900</b>

2.15 **Lines of action.** A number of programs have been preselected for the health sector because their outcomes will go a long way towards reaching the targets established in component 1 and to fulfillment of the HIPC completion point conditions. These programs are (i) project for institutional restructuring and extension of basic health

services with IDB financing (increased coverage of mother and child care by means of basic packages); and (ii) health sector reform program, with financing from the World Bank (promotes increased formal health insurance coverage and fewer government subsidies).

- 2.16 In the case of education, a number of programs have been preselected because they are closely connected to the targets of increased coverage of basic education in rural areas, greater participation by parents in monitoring teacher performance and quality. These programs are (i) EDUCATODOS, financed by USAID, (ii) literacy and basic education program for adults, AECI; (iii) academic excellence awards, nationally funded; (iv) national education transformation programs, IDB; and (v) community education project (PROHECO), IDA.
- 2.17 In the case of the PRAF, the basic criterion for selection will be the contribution that is made to the targets for vulnerable groups and social equity. The programs selected are (i) school vouchers for grades one through four, (ii) mother child vouchers, (iii) a senior citizens program, (iv) integral development for women and families; and (v) the PRAF II program, encompassing several of the above items.
- 2.18 For the FHIS, selection focuses on programs and projects having an impact on rural areas that supplement the steps taken to reduce child mortality. The following programs and projects have been selected (i) water and sanitation pilot program, (ii) project cycle delegation project, and (iii) physical infrastructure program.
- 2.19 For disbursement of the **first tranche**, the following condition must be fulfilled to the Bank's satisfaction:
- (i) Evidence that the 2004 Fiscal Year Budget Revenues and Expenditure Act introduced to Congress includes funding for priority programs agreed on with the Bank. (The specific matrix of physical and financial targets can be found in the program's technical files.)
- 2.20 For disbursement of the **second tranche**, the following condition must be fulfilled to the Bank's satisfaction:
- (i) Evidence officially documented by SEFIN demonstrating that physical and financial targets for programs accorded priority for 2004 have been reached or exceeded.

### **3. Administration of ministries involved in the implementation of the PRS**

- 2.21 This subcomponent seeks to assist the Ministry of Health and the Ministry of Education in effecting changes in their management enhancement policies and in attaining the PRS-linked annual and global targets. To accomplish this aim, the ministries will have to be given the authority and capacity to rationalize spending

on personnel, make service delivery more efficient, and to be able to draw on the private sector to supplement services offered by government.

**a. Health subcomponent**

- 2.22 **Objective.** To complete the administrative reforms that would enable the Ministry to develop a long-term strategic plan promoting a sector approach to leverage external assistance and expedite the outsourcing of services as a means of expanding primary care coverage as part of the new arrangements to delegate authority and resources to hospitals providing more effective support for efforts to serve the most vulnerable population groups, based on a renewed personnel administration system that would broaden service coverage and quality.
- 2.23 **Lines of action.** The following lines would be applied: (i) implementing the strategic plan for the health sector to 2021, through broad discussion with civil society and external cooperation agencies; (ii) establishing a general hospital policy and changes to budget legislation seeking, in the medium term, to delegate authority and budget resources of a group of regional hospitals; (iii) creating a legal framework for granting the Ministry of Health the authority to outsource services and to formulate and implement a budget based on this new structure, permitting the effective contracting in the medium term of portions of the public budget; and (iv) performing an audit of positions and salaries for at least 30% of the Ministry (see Annex I, Policy Matrix).
- 2.24 For disbursement of the **first tranche**, the following conditions must be fulfilled to the Bank's satisfaction:
- (i) Officialization of the Strategic Plan for the Health Sector to 2021;
  - (ii) Issuance of the ministerial decree by the health authority that approves hospital policy;
  - (iii) Inclusion in the draft budgetary legislation for fiscal 2004 presented to Congress of an article empowering SEFIN to transfer authority, resources and responsibilities to give hospitals greater autonomy and flexibility in budget performance;
  - (iv) Issuance of a ministerial decree by the health authority that approves regulations governing the prequalification, selection and award of contracts for health services;
  - (v) An audit of positions and salaries of at least 30% of social security personnel; and
- 2.25 For disbursement of the **second tranche**, the following conditions must be fulfilled to the Bank's satisfaction:

- (i) Evidence that at least five hospitals have taken greater responsibility for budget management and execution under the auspices of the new hospital policy and the flexible budget guidelines approved for 2005, on the terms agreed in subparagraph (iii) of the first tranche;
- (ii) Evidence that the social security directorate has signed at least three contracts in an aggregate amount of at least 20 million lempiras, applying the new management models stipulated in the regulations referred to in subparagraphs (iii) and (iv) of the first tranche;
- (iii) Completion of the audit of positions and salaries mentioned in subparagraph (iv) of the first tranche for 100% of the social security staff, and the reclassification of positions, reassignment of functions, redistribution of posts and any other personnel action resulting from the audit of at least 70% of all employees that are eligible in accordance with the audit, under the applicable legal and regulatory framework.

#### **b. Education subcomponent**

- 2.26 **Objective.** This subcomponent seeks to strengthen institutional capacity in the educational sector at the central and deconcentrated levels, and to rationalize resource administration and allocation, especially for teachers. The purpose is to enable the country to make progress on meeting the proposed coverage and quality targets. Fiscal relief in education combines different measures, some of which are structural and others preliminary and still others concerned with implementation. As to containing spending on salaries to adjust it to the country's fiscal situation, the government is making headway in that direction. Its progress will be monitored under a new program that is part of the IMF PRGF facility. The other preparatory measures are concerned mainly with the implementation of the systems for audits of positions. Implementing these measures will involve reclassifying and redistributing teachers in irregular situations as identified through application of this mechanism.
- 2.27 **Lines of action.** Preparing an organizational reengineering effort for departmental education directorates in order to implement a new management system for the deconcentrated system. This new system is based on the center of education as the fundamental unit and is intended to separate technical-teaching support functions from administrative and financial training functions, both in coordination with social and community management. Social and community management would be reflected in the educational development associations. It is hoped that the system will become an effective mechanism for teacher supervision to raise the quality of teaching and support the increase in effective classroom time; (ii) as an adjunct, an audit of 80% of the ministry's positions and salaries will be performed as a basic input for the monitoring system, redistributing and reclassifying teachers supporting the expansion of coverage; and (iii) approving and developing a new national

elementary education curriculum as a normative instrument setting out capacities, competencies, concepts, skills and attitudes expected of all those within the national education system.

2.28 For disbursement of the **first tranche**, the following conditions must be fulfilled to the Bank's satisfaction:

- (i) Evidence that the Ministry of Education has issued a ministerial decree regulating the inner workings of the departmental education directorates;
- (ii) Presentation of an audit report on positions and salaries of 80% of the teaching staff prepared by a specialized entity acceptable to the Bank;
- (iii) Evidence that the Ministry of Education has issued a ministerial decree authorizing and officializing the national elementary school curriculum to be applied to all official, semi-official and private centers of education at the national level.

2.29 For disbursement of the second tranche, the following conditions must be fulfilled to the Bank's satisfaction:

- (i) Evidence that the implementation of the new system referred to in subparagraph (i) of the first tranche has enabled: (i) the transfer of 200 officials from departmental directorates to perform teaching duties; (ii) creation and commencement of operations of 2,000 local educational development associations (ADELs), and that these are receiving the appropriate budget transfer from the Ministry of Education; and (iii) compliance with the 190 effective days of classroom time in 2004 as confirmed by departmental education directorates;
- (ii) Evidence that 100% of the audits of posts and salaries of teaching staff referred to in subparagraph (ii) of the first tranche have been completed and that at least 90% of eligible cases identified by the audits in accordance with the applicable legal and regulatory framework have been reclassified and redistributed.

### **C. Cost and financing of the program**

2.30 The total cost of the program is estimated at US\$30 million, to be drawn on the Fund for Special Operations in United States dollars. The financing will be divided into two tranches of US\$15 million each to be disbursed once it has been verified that the targets and indicators set out in the matrix of conditions have been fulfilled (see Annex I).

**D. Sources and conditions of financing**

2.31 The loan conditions are indicated below:

Sources of financing:	IDB: Fund for Special Operations (FSO)
Amount of the operation:	US\$30 million
Amortization period:	40 years
Grace period:	10 years
Disbursement period:	2.5 years
Interest rate:	1% during the grace period, and 2% thereafter
Inspection and supervision:	1% of the loan amount
Credit fee:	0.50% per annum on the undisbursed balance from the date of approval by the Board
Currency:	United States dollar



### **III. EXECUTION OF THE PROGRAM**

#### **A. The borrower and the executing agency**

- 3.1 The borrower will be the Republic of Honduras and the Secretary of State in the Office of Finance (SEFIN) will be responsible for administration and supervision of the program in conjunction with the Ministry of Education, the Ministry of Public Health, and the PRAF, and the FHIS, which will be responsible for establishing and fulfilling the agreed targets and carrying out policy actions provided for under the program. SEFIN will make every effort to fulfill the conditions governing disbursement of the two tranches.

#### **B. Execution and overall administration of the program**

- 3.2 As a key actor in formulating government economic and social policy, SEFIN will work closely with the Ministry of the President's Office (SPD). As in the case of the policy-based loan now in progress, SEFIN will be responsible for general monitoring of the program. For this new program, the SPD will be responsible for monitoring the progress made in meeting the interim targets of the PRS as part of the functions conferred on it by the SIERP. Each ministry will also work with the line ministries and autonomous or decentralized institutions in charge of implementing the PRS. SEFIN will enter into inter-agency agreements establishing that each ministry is committed to fulfilling the program targets and ensuring liaison staff of these institutions with SEFIN for purposes of assisting with implementation of the program.
- 3.3 SEFIN will establish a project coordinating unit (PCU) and will designate a coordinator for the present program, who will be responsible for verifying compliance with the financial and physical targets of priority programs. The SPD will designate two of its members as technical liaisons with the PCU coordinator for purposes of coordinating the monitoring of the targets.
- 3.4 The PCU will be responsible for the following activities: (i) preparing quarterly progress reports as input for regular meetings for evaluation and discussion with participants in order to take timely decisions making it possible to attain targets by the established deadlines; (ii) collaborating with participants to gauge the extent to which conditions set out in the policy matrix have been fulfilled and to monitor compliance with PRS annual targets; (iii) to ensure compliance with contractual obligations and to prepare documentation and reports specified in the loan contract; and (iv) serving as counterpart for administration missions scheduled during implementation of the program.

**C. Execution and disbursement amounts and schedule**

- 3.5 The program will be carried out in a period of not less than 18 months and the proceeds of the loan will be disbursed in two tranches that are expected to be of US\$15 million each. Based on projections for completion of the policy actions agreed on for the first tranche, the first disbursement is expected to be made in January 2004. The second tranche is expected to be disbursed upon fulfillment of the policy actions agreed on to the Bank's satisfaction within a period of 18 to 24 months from the date of contract signature.

**D. Conditions for processing disbursements**

- 3.6 Disbursements will be conditional on the borrower, to the Bank's satisfaction (i) maintaining a macroeconomic environment consistent with the objectives of the program, and (ii) fulfilling the policy actions agreed on for each tranche as specified herein in chapter II and Annex I.
- 3.7 To monitor the poverty reduction targets, the Bank will perform random audits of information sources and records.

**E. Program monitoring and evaluation**

- 3.8 In discussions concerned with preparation and negotiation of this program, agreement was reached on annual targets and indicators to measure the impact of the program on human capital development during program execution. Although the targets for 2004 are the only ones linked to disbursements, the fact that they must be monitored up to 2006 will mean that the government is making progress in attaining its poverty reduction objectives and therefore these interim targets will be a good proxy for assessing the effectiveness of this loan after all financing has been disbursed. Because the program targets all Hondurans living in poverty it was not possible to isolate a control group in order to evaluate their situation with and without the project. However, working with a baseline, it would be possible to verify whether any progress has been made towards achieving the proposed targets.
- 3.9 To supplement the interim indicators, the progress made in reducing child and maternal mortality will be measured as global indicators of the success of the PRS. All of the impact indicators will be monitored in a concurrent annual report at year end 2006 and a final ex post evaluation report (2007). The project team has prepared an extended version of the matrix for monitoring the education sector containing a breakdown by gender and area (rural and urban). This matrix will be used for concurrent evaluations and the final program evaluation.
- 3.10 The Government of Honduras policy letter expressed a commitment to cooperate directly and through the executing agency, furnishing information, data, and any documentation that may be requested, and offering such technical, logistical, and

administrative support that may be requested. In addition, it contains a commitment to finance and perform these evaluations in conjunction with the Bank.

**F. Policy letter**

- 3.11 The Bank is in agreement with borrower on the policies outlined in the policy letter attached hereto as Annex III. The letter sums up the government's economic policies, the commitment to implement the PRS, and the decision to promote significant reforms in health, education, and social security policy based on indicators specifically agreed on.

**G. Inspection and supervision**

- 3.12 The Bank will establish such inspection procedures as it considers appropriate for satisfactory execution of this program. The borrower will cooperate fully offering such assistance and information as may be required for this purpose. Supervision of the program will be the responsibility of the Bank's headquarters, in coordination with its Country Office in Honduras.
- 3.13 To this end, the Bank will analyze on each of its inspections: (i) the progress made in overall implementation of the program, (ii) the progress made fulfilling the conditions precedent to the second disbursement, (iii) the experiences gained in implementing the policy reforms and any problems encountered, (iv) fulfillment of the indicators established for each component, and (v) any other topics that may be relevant to program execution.

## **IV. VIABILITY AND RISKS**

### **A. Political, technical, and institutional viability**

- 4.1 Broad public participation in formulating the PRS gives it legitimacy and a sound basis on which to implement it. The final document was the outcome of months of analysis and discussion with government officials, representatives of civil society, and members of the cooperative community. The establishment of the Consultative Council and the Poverty Reduction Fund offers a conduit for accessing information by the various actors involved in decisions on prioritizing programs and the use of resources.
- 4.2 The sensitive issues of monitoring PRS progress indicators will have two basic support indicators—the SIERP which consolidates information on the progress made in attaining the targets and the BIP-SISPU which links program implementation to global targets. These instruments will provide reliable updated information to the ministries in the social sectors and to the Consultative Council on the progress made in carrying out the PRS so that time decisions may be taken to expedite the process. SEFIN will receive support from a coordinating unit (PCU) consisting of technical staff and experts who took part in designing the proposed program. This will ensure that there is sufficient counterpart funding to monitor program execution and to attain the targets and indicators agreed on with the Bank in a timely manner.
- 4.3 From a political standpoint, efforts to reduce poverty have been accorded priority by the outgoing administration and the new Honduran government, giving it a stable political foundation that is necessary for moving ahead with the PRS.
- 4.4 With respect to the technical viability of the activities that must be carried out for fulfillment of the conditions, each one was defined and agreed on in close cooperation with the line ministries in charge of fulfilling them with the monitoring of experts from SEFIN, SDP, and UNAT. The consensus on the viability of the actions, the feasibility of implementing them by the established deadlines, and the government's commitment to them is reflected in the Policy Letter (see Annex III).
- 4.5 More importantly, according to the findings of outside consultants, the systems now in place to support such monitoring and follow up (i.e. the PRF, SIERP, SIAFI, BIP-SISPU), which have been targeted for support by the Bank are considered suitable and relevant.

### **B. Benefits**

- 4.6 The main benefits accruing from the program will be the advances made in reducing poverty in Honduras, as measured by the progress in attaining the targets

for improvements in health and education provided for in the PRS. The idea is to create an institutional setting that tends to align performance with the agreed targets. The progress made in reaching the poverty reduction targets brings the country closer to the HIPC completion point, which would in turn enable it in the medium term to reduce substantially its external debt and to boost economic growth.

#### **C. Environmental considerations**

- 4.7 The program is feasible from an environmental standpoint insofar as no adverse environmental effects are expected to be produced because most of the planned activities will focus on the efficiency and effectiveness of social spending and on promotion of regulatory standards and rules for education, health, and social security. For the component to monitor the physical and financial targets of priority programs, the project team worked together with the FHIS authorities to verify that protected investments conform to applicable environmental standards. Verification was done by means of a review of reports on the corresponding programs and projects. In the case of health, promoting the concept of autonomous hospitals will go hand in hand with support for implementing environmental measures to deal with hospital waste.

#### **D. Risks**

- 4.8 As noted in the background section, the social reforms proposed could be resisted by different sectors of society, which would in turn affect its political viability. The project team has reviewed the viability of the reforms while the program was being prepared and is of the view that the rate of advance proposed is compatible the government's institutional possibilities. The establishment and implementation of a consultative council consisting mainly of representatives of government and civil society will organize debate on a footing where dissent and dispute are structured and conducive to building a consensus and reaching agreement. In addition, the reforms spurred under the program have been part of the PRS, which entails a high degree of consultation and consensus with civil society.
- 4.9 Another risk has to do with a possible failure to attain the interim targets in the social sectors (component 3). To assuage this risk, the program will establish unequivocal and realistic indicators in each case. The quarterly monitoring system will make it possible to fulfill in a timely manner all of the conditions and also to help mitigate this risk.

- 4.10 The HIPC initiative entails a process of fiscal austerity. At the same time, the PRS proposes to develop new social programs that make indispensable a strict planning process to narrow the gap between expectations and available resources. In this setting of fiscal retrenchment, the government could postpone existing social reform programs and that is why this operation, by promoting policy reforms that aim to enhance the efficiency of spending and to protect priority programs seeks to ensure continuity in the movement of the PRS and to fulfill the social goals associated with it.

**E. Impact of the program on women and vulnerable groups**

- 4.11 Given that the aim of the PRS is to halve the level of poverty by the year 2015, initiatives in the areas of health and education will focus largely on addressing the unmet needs of the poor. For instance, there are key indicators that measure maternal and child health. Monitoring programs and projects with a high content of services for mothers, children, and vulnerable groups will allow the country and the Bank to ensure that programs are properly implemented, physical targets monitored, and the necessary financing obtained for completion.

**F. Classification of social equity and poverty reduction**

- 4.12 Since the program beneficiaries are the people of Honduras, including high-risk groups, the operation qualifies as a social-equity enhancing project as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). The targets and indicators agreed on for monitoring the program will reflect the performance of actions to measure improvements in social equity.
- 4.13 Given the program's approach of helping to reduce poverty under the PRS, since it is a policy-based loan, it does not qualify as poverty targeted investment.

**POLICY MATRIX**  
**POVERTY REDUCTION SUPPORT PROGRAM**

Problem	Actions	Impact	Conditions precedent to disbursement	
			First Tranche	Second Tranche
Stable Macroeconomic Climate				
Instability and low growth make it difficult to implement the PRS.	Maintain stability and economic growth conducive to successful implementation of the poverty reduction programs.	Stable macroeconomic climate.	A macroeconomic climate consistent with the objectives of the program is maintained.	A macroeconomic climate consistent with the objectives of the program is maintained.
I. Performance-Based Management				
Implementing the PRS is a complex process given its magnitude. To monitor the progress made, interim indicators that can be evaluated regularly will need to be developed so that the necessary adjustments can be made based on the results obtained.	Agree on a set of interim indicators associated with implementation of the PRS and annual targets for the next five years.	GOH capacity to link policy and investment measures to monitoring of the PRS poverty reduction targets.	i. The selection of interim and product indicators associated with global targets of the PRS and for each one a definition, establishment of a base line, source of information, and annual targets for four years according to Annex II.	i. Progress report on interim PRS monitoring indicators demonstrating that annual targets established for 2004 have been met substantively; and  ii. Evidence that the SIERP has been implemented, generates monitoring reports on indicators and targets, and disseminates the results in accordance with its design.
II. Efficiency in the Selection and Implementation of Priority Programs				
A. Subcomponent of prioritizing, monitoring, and coordination				
Financial programming does not cover a medium- and long-term horizon.	Begin the process of implementing the multiyear budget set forth in the Budget Act.  Create the budget framework to move forward with SWAP-type sector approaches.	Financial planning is used as an instrument to establish program priority based on the poverty reduction strategy.  The legal framework of the multiyear budget has been strengthened.	i. Presentation for consideration by the National Congress of the multiyear financial program for the 2004-2007 period ii. Official letter submitted to the National Congress requesting the introduction of a legal framework for multiyear budgeting into the draft legislation on financial administration. iii. Action plan to place the sector approach into budgetary effect in at least two sectors.	i. Presentation for consideration by the National Congress of the multiyear financial program for the 2005-2008 period ii. Action plan for 2005 budget has been implemented.
B. Physical and financial targets subcomponent				
There are many programs and insufficient capacity to implement them.	Agree on a series of priority programs under the control of institutions forming the PRS with financing from national sources and from loans and grants.	Health, education, and PRAF programs analyzed and accorded priority, thus enhancing their impact on poverty reduction.	i. Evidence that the Budget Revenue and Expenditure Act introduced to Congress in 2004 includes the amounts for priority programs agreed on with the Bank pursuant to Table II-1 of the loan proposal.	i. Evidence substantiated in an official report from SEFIN, demonstrating the physical and financial targets of the priority programs for 2004 indicated in Table II-1 of the loan proposal have been reached or exceeded.

Problem	Actions	Impact	Conditions precedent to disbursement	
			First Tranche	Second Tranche
III. Management of ministries associated with PRS implementation				
A. Health subcomponent				
Four factors accounting for most of the sector’s management problems have been identified: (i) an uptrend in payroll costs of the Ministry and the lack of work supervision; (ii) legal and organizational constraints of the Ministry of Health for outsourcing services; and (iii) hospital productivity is low.	<p>Promote the use of a long-term strategic plan that makes it possible to adopt SWAP-type sector approaches.</p> <p>Use a hospital policy that guides sector actions.</p> <p>Expand coverage of the basic health package under a legal framework for outsourcing.</p> <p>Rationalize staff at the Ministry.</p>	Provide the Ministry with the authority and capacity to plan strategically for the long term, rationalize spending on staffing, deliver services more efficiently, and offer additional supply through the private sector.	<p>i. Officialization of the Strategic Plan for the Health Sector to 2021;</p> <p>ii. Issuance of ministerial decree by the health authority that approves hospital policy;</p> <p>iii. Inclusion in the draft budget legislation for fiscal 2004 presented to Congress of an article empowering SEFIN to transfer authority, resources and responsibilities to give hospitals greater autonomy and flexibility in budget performance;</p> <p>iv. Issuance of a ministerial decree by the health authority that approves regulations governing the prequalification, selection, award, and contracting of health services.</p> <p>v. Audit of positions and salaries of at least 30% of social security personnel</p>	<p>i. Evidence that at least five hospitals have taken greater responsibility for budget management and execution under the auspices of the new hospital policy and the flexible budget guidelines approved for 2005, on the terms agreed in subparagraphs (ii) and (iii) of the first tranche;</p> <p>ii. Evidence that the social security directorate has signed at least three contracts in an aggregate amount of at least 20 million lempiras, applying the new management models stipulated in the regulations referred to in subparagraphs (iii) and (iv) of the first tranche;</p> <p>iii. Completion of the audit of positions and salaries referred to in subparagraph (iii) of the first tranche for all social security personnel, and the reclassification and redistribution of at least 70% of all eligible staff according to the audit under the applicable legal and regulatory framework.</p>
B. Education subcomponent				
Four major weaknesses in management of the subsector have been identified: (i) shortcomings in organization and regulation; (ii) internal inefficiencies make it difficult to increase coverage; (iii) absence of supervision of teachers; and (iv) poor quality education.	<p>Obtain regulatory framework to give departmental directorates a new guideline for their deconcentrated activities to enhance supervision.</p> <p>Develop position audits and take respective actions to reorganize teaching staff and expand coverage.</p>	<p>i. Increased administrative and academic efficiency in the ministry;</p> <p>ii. Greater coverage together with lower repetition.</p> <p>iii. Increased supervision of teachers and more effective classroom days.</p> <p>iv. Measurement and gradual increase in the quality of education.</p>	<p>i. Evidence that the Ministry of Education has issued a ministerial decree containing internal regulations for the departmental education directorates;</p> <p>ii. Submission of a report on the audit of at least 80% of the positions and salaries of teaching staff, prepared by a specialized agency acceptable to the Bank;</p> <p>iii. Evidence that the Ministry of Education has issued a decision authorizing and officializing the national elementary school curriculum to be applied to all official, semi-official and private centers of education at the national level;</p>	<p>i. Evidence that the implementation of the new system referred to in subparagraph (i) of the first tranche has enabled:</p> <p>(a) the transfer of 200 officials from departmental directorates to perform teaching duties;</p> <p>(b) creation and startup of 2,000 local educational development associations (ADELs), which are receiving the appropriate budget transfer from the Ministry of Education; and</p> <p>(c) compliance with the 190 effective days of classroom time in 2004 as confirmed by departmental education directorates.</p> <p>ii. Evidence that 100% of the audits of positions and salaries of teaching staff referred to in subparagraph (ii) of the first tranche have been completed and that at least 90% of eligible cases identified by the audits in accordance with the applicable legal and regulatory framework have been reclassified and redistributed.</p>



## GLOBAL TARGETS OF THE PRS FOR 2015 AND INTERIM TARGETS AND INDICATORS

PRS targets for 2015	Interim targets		Annual targets					
			2002	2003	2004	2005	2006	2007
HEALTH								
Reduce maternal mortality by one half from 147 per 100,000 live births in 2000 to 73 per 100,000 live births	Institutional delivery and birth care		97.089	92.839	100.299	101.944	103.616	105.315
	First-time prenatal care		192.946	164.624	194.103	195.268	196.433	197.618
	Post partum care		98.836	87.508	95.343	96.106	96.874	97.649
	Number of women of child-bearing age receiving some form of family planning.		158.720	194.722	162.529	166.429	170.424	174.514
Reduce mortality in infants under 1 year from 33 per 1,000 live births in 2000 to 17 per 1,000 live births	Number of children under 1 year with all vaccinations	One dose of polio vaccine	181.826	184.076	185.420	186.773	188.641	190.527
		One dose of vaccine for diphtheria, tetanus, pertussis, hepatitis B, and haemophilus influenza type b	182.333	184.076	185.420	186.773	188.641	190.527
		One dose of BCG vaccine for tuberculosis	181.417	184.076	185.420	186.773	188.641	190.527
Reduce mortality in children under 5 from 44 per 1,000 live births in 2000 to 22 per 1,000 live births	Number of children 1 to 4 with all vaccinations.		190.954	186.268	189.889	191.275	192.671	194.598
	Timely care for children under 5 with diarrhea.		247.169	198.964	249.566	251.987	254.432	256.900
	Timely care for children under 5 with acute respiratory infections		735.870	666.236	742.871	749.939	757.074	764.276
EDUCATION								
Double net coverage in preschool education for children of age 5	# of children enrolled in preschool (final enrollment)		158.062	175.343	192.624	209.905	227.186	244.467
Net coverage of 95% in first two cycles (grades 1° to 6°) of basic education	# of children enrolled in first cycle (grades 1 to 3; final enrollment)		210.612	213.771	216.978	220.232	223.415	226.621
	Urban		420.013	430.513	441.276	452.308	462.939	473.704
	Rural							
	# of children enrolled in second cycle (grades 4 to 6; final enrollment)		159.142	161.529	163.952	166.411	168.816	171.239
	Urban		233.819	239.664	245.656	251.798	257.716	263.709
	# of repeaters in first cycle		56.795	34.610	20.766	12.460	7.534	4.541
	# of repeaters in second cycle		14.120	8.604	5.162	3.097	1.873	1.129
Net coverage of 70% in third cycle (grades 7° to 9°) of basic education	# of children enrolled in third cycle (grades 7 to 9; final enrollment)		197.737	223.237	249.937	277.837	303.937	330.637
	Urban		28.719	39.991	53.621	69.873	82.588	96.456
	Rural							
50% of the work force have completed secondary school	# of young people between ages of 15 and 18 enrolled in secondary school (grades 10 to 12, final enrollment)							
	Urban		119.904	124.891	127.384	129.937	131.948	133.612
	Rural		16.094	16,764	17.099	17.441	17,711	17.935

## TECHNICAL NOTE

### Health

Information will be taken from the official report contained in the Outpatient Care Statistical Information Bulletin. The information in the final annual report are released in July of the following year.

#### Definitions:

**Institutional delivery.** Delivery refers to the culmination of the pregnancy after 22 weeks of gestation, with the birth of boy or girl stillborn or alive. Institutional refers to the fact that delivery took place in any establishment of the Ministry of Health.

**Prenatal care.** This is the care provided by a qualified health care worker responsible for providing care to mothers during pregnancy. It involves examining the woman's general condition, weight, waist size, vital statistics, arterial hypertension, and health. It is noted that at least one examination has been made.

**Post-partum care.** Care by a qualified professional who examines the new mother's general condition for the first month after giving birth.

**Family planning.** Advisory services on family planning given to women of child-bearing age by a qualified professional. Child-bearing age is from 15 to 49 years of age.

**Full vaccination cycle.** One BCG inoculation; 3 polio inoculations; 3 inoculations for diphtheria, tetanus, pertussis, hepatitis B, and haemophilus influenza type b; and one inoculation for measles and rubella.

### Education

Information will be taken from the Ministry of Education's Statistical Report. This document reports initial and final enrollment data for each year. Final figures for the year are released in June of the following year.

#### Definitions:

**Enrollment.** Refers to gross enrollment, which includes repeaters.

**Repeaters.** Are children repeating their grade.

**Single-teacher schools.** Are schools with a single teacher for all grades.



**MINISTRY OF FINANCE  
REPUBLIC OF HONDURAS**

Tegucigalpa M.D.C. 11 November 2003

***Mr. Enrique Iglesias***  
President  
Inter-American  
Development Bank (IDB)  
Washington, D.C.

Dear Mr. President,

Our country's Poverty Reduction Strategy (PRS) has been in effect for one year and a recent report assessed its performance. As in the case of other countries that have benefited from the HICP initiative, this first year has been a learning experience, in which we implemented innovative standards and procedures and were able to learn from the experiences by other nations and have carried out similar strategies before us. The document was scrutinized by the sector groups (government, civil society, and cooperants), taking part in the dialogue and consensus defined in the PRS as its consultative mechanism. To this end, nine workshops were organized for the most representative groups of Honduran society—women, nongovernmental organizations, local government, campesino groups, workers, the private sector, and ethnic minorities.

The report found that there is still a long way to go in the struggle to reduce poverty. The combined effects of export sector performance, the fiscal situation, an overly ambitious timetable at the outset, and the delay in reaping the benefits of external debt relief converged to prevent the strategy from meeting its initial targets. Here it should be noted significant progress was indeed achieved in important aspects such as the implementation of the PRS, project prioritization, and administration of additional resources. Progress in the areas of rural poverty reduction, social protection, and sustainability was acceptable in the programs and subprograms implemented. More still needs to be done, however, to boost economic growth, reduce urban poverty, and develop human capital.

Given these results, it is felt that certain aspects of the strategy need to be updated. First, tangible results in the 2003-2005 must be obtained and elucidated, by bringing the activities of the government and donors into line with one another in the key program areas as a criterion for targeting programs to the country's most vulnerable sectors. Also, it is important to broaden the strategy's budgetary approach since the original

A handwritten signature in black ink, consisting of a stylized 'H' followed by a long, sweeping diagonal stroke.

design underestimated national expenditure, which accounts for over 65% of total outlays on poverty. In this same vein, additional external resources must be arranged quickly to help defray part of the existing financing gap.

Such an update is not for a moment intended to modify the underlying elements of the PRS. The government holds firm on the strategy's long-term vision to 2015, the strategic guidelines, and the poverty reduction targets. Reducing the proportion of the population living under the poverty line from 66% in 2000 to 42% by 2015 continues to be the fundamental objective.

### **1. Background: Macroeconomic context**

Since taking office in 2002, President Ricardo Maduro's administration has continued to be faced with macroeconomic problems brought about by the worldwide recession, deteriorating terms of trade caused by higher fuel prices, and declining commodity prices, particularly that of coffee. For the year, GDP expanded by just 2.7%, in line with population growth thus making for a situation of stagnating per capita GDP.

Macroeconomic management was seriously undermined by a fiscal policy geared to the 2001 elections. Public sector payroll expenses exceeded the economy's financing capacity leading to a slump in current savings in the public sector and a sharp divergence from the fiscal targets of the IMF program. The salary increases, which were passed into law, affect over 70% of the central government's payroll (remuneration of teachers, doctors, nurses, and other officials in the social sectors).

In 2002 and 2003, the government took action to shore up public finances. The most significant measures included improvements in tax administration, a new agreement with the teachers, setting salaries below the statutory levels, a freeze on all other public sector salaries, and a widening of the tax base through the elimination of exemptions and deductions. Yet, despite these steps, the public sector deficit will amount to 4.5% of GDP by the end of 2003.

As a result of the government's actions, negotiations with the IMF were able to continue throughout the period and are expected to conclude in December 2003 with agreement on a new poverty reduction and growth facility (PRGF) for 2004-2006.

Delays in reaching the HIPC initiative completion point have had an impact on the PRS since Honduras has been compelled to use its own resources to service its multilateral debt on its own. At the same time, it has fallen behind on loans and the additional financing contemplated in the strategy has not materialized. This situation has meant that the budget for financing the PRS is more than 2% of GDP lower than originally projected in the strategy.

President Ricardo Maduro's administration is finalizing negotiations on a program with the International Monetary Fund as part of the PRGF, which incorporates the PRS itself

as its most important component that was reviewed and validated by the Consultative Council, a consultative civil society body. The program is expected to be approved by the IMF's Executive Board in early 2004.

In the context of the Great National Dialogue, the government in conjunction with civil society, the private sector, and different professional associations within the country, is discussing a Fiscal Accountability for Sustainable Development Act, as a regulatory mechanism for administration of public finances, for the purpose of meeting the targets set out in the Development Program that involves balancing State revenues and expenditures, improving the quality and performance of public spending in order to enhance transparency in the administration of fiscal revenues, rational use of spending, investment, borrowing, and transparency, with a view to attaining the targets of the macroeconomic program and to generate more resources for the PRS. This new legislation will apply generally to all three branches of the State and to local government and monitoring compliance with this legislation and the recommendations and powers accorded under the Fiscal Accountability Pact will fall to the Special Monitoring Commission (COESE).

## **2. The economic program and social policy**

### **A. The government's economic program**

The program will focus on the following areas of priority i) the fiscal front, where steps will be taken to achieve a higher level of public savings so that financial resources can be channeled to investment projects, particularly those that target poverty reduction; ii) a more dynamic and efficient PRS; iii) a monetary policy that continues to bring down inflation, protect international reserves, and ensure that the financial system can continue to be an adequate source of credit for the private sector; and iv) strengthening of a financial system that strongly favors productive investment and economic growth.

The key to this entire program will be the consolidation of the public sector's financial position in order to free up resources for implementation of the PRS and to bring the public sector's borrowing requirements into line with the supply of concessional financing the country will receive in the years ahead. To this end, the program's fiscal budget provides for higher current fiscal revenues, lower current spending, to be reflected in payroll representing a smaller share of overall outlays and increased spending on investment consistent with the PRS targets.

Thus, the combined public sector BCH deficit targets for 2004-2006 are on a downward path to around 3% of GDP. Fiscal policy will be backed by an adequate legal framework in terms of both revenue and expenditure, as the Executive Branch is given the tools for securing the targets contemplated including public sector wage policy.

These efforts will go hand in hand with a monetary and exchange rate policy tailored to maintaining price stability and an exchange rate that favors a more competitive position, reflecting the fact that the country has a lower inflation rate than its trading partners. Inflation is expected to continue falling from 7.5% in December 2003 to approximately 5% upon completion of the program.

Against this backdrop, the export sector will enable the Central Bank to maintain its net international reserves at the equivalent of over 4 months of imports. These improvements are reflected in a narrowing of the current account deficit driven basically by export growth and higher remittances amounting to around 15% of GDP.

Strengthening the macroeconomic picture and creating an attractive investment climate will be backed by improvements in financial intermediation that reinforce the financial system and bank supervision. For instance, the program includes reforms to the legal framework for supervision and administration of the system, actions that will be accompanied by a program to strengthen the banking system. Taken together, these initiatives will produce greater macroeconomic stability and lower intermediation costs.

Another pillar of the program is the implementation of the PRS. A broader consultative process with civil society and cooperants that led to a review of the performance of the strategy in its first two years, which will be described in due course, as well as of its priorities. Accordingly, a more targeted strategy is now available with the necessary tools for monitoring and control to ensure that adjustments are made promptly thus assuring accomplishment of the goals.

The PRS will benefit from efforts on the fiscal front. This will free up resources and increase efficiencies in different sectors so that the targets established in the strategy can be attained. Since further efforts will be needed for the PRS in 2004 the country will be unable to benefit from the debt relief originally envisaged in the strategy, as the HIPC completion point will not be reached until the first quarter of 2005. To keep up the pace at which the strategy is being implemented, more contributions in the form of external financing are anticipated to speed up implementation of the PRS, which underpins fulfillment of the conditions established for reaching the completion point.

The support of the IMF Executive Board for the program is expected in early 2004, an event that will facilitate discussions of the consultative group in the first quarter of next year.

## **B. Social policy and projected reforms**

We acknowledge that in recent years spending for poverty reduction has been fairly moderate although social spending was up as a share of overall public spending, rising from 47% in 2001 to 49% in 2002, compared with 44% in 2000, to exceed the target figure. This improvement, however, was attributable in part to wage adjustments and

not to real increases in resources allocated to these sectors or higher productivity. As a consequence, the coverage of social services did not change significantly. To this end, the government has made major adjustments to the PRS with an eye to expanding the budgetary framework to incorporate efforts funded out of national resources under poverty reduction spending. Also, a broad-based approach is planned considering the current spending that is needed to deliver services and not just capital spending. Such expenses are extremely relevant to accomplishing many of the goals, particularly those concerned with human development (education and health).

### **Implementation and monitoring of the PRS**

One important aspect is the mechanism for monitoring the progress of the PRS through selected targets and indicators (PRSMS). The government designed the PRS Indicator Monitoring System (SIERP) which was reviewed by the PRS consultative group and approved by the Social Cabinet. This system is coordinated by the Technical Support Unit (UNAT) of the Secretariat of the President's Office (SDP).

The PRSMS is now being applied on a trial basis in the UNAT server. At its present stage of development, some areas of design need to be adjusted and/or modified to ensure smoother functioning in its short-term application. Until now, the data base has been fed mainly with data from the PRS base line and targets at the local level as well as additional data from certain quantitative (impact) and qualitative (policy measures) indicators generated by institutions such as the Ministry of Education, the Ministry of Finance, the Ministry of Natural Resources and Environment, the Ministry of Health, and the Central Bank of Honduras. Information is also available from 36 IDB-financed projects.

In this setting, we need to begin coordinating the efforts of the institutions that will be stakeholders in the system in order to establish a working methodology. To facilitate the PRSMS, capacity for processing and independence needs to be expanded in order to ensure data security. In addition, a virtual Web site must be created as a first step towards securing a readily identifiable and dedicated Internet address for the PRSMS. To accomplish this aim, the IDB is providing assistance in the form of nonreimbursable technical cooperation funding to reinforce monitoring capacity in three areas i) technical assistance for the design of a legal and operational framework; ii) support for information production; and iii) system administration.

In addition, the PRSMS will make it possible to monitor the midterm indicators for the PRS overall targets. The government proposes to link policies and investment decisions to the accomplishment of these basic targets. It will also expand the use of the Public Investment System Integrated Project Bank (BIP-SISPU) so that progress in public investment projects can be monitored on an ongoing basis in conjunction with Financial Administration System consolidation (SIAFI) as a vehicle for financial management of the country's consolidated budget.

## **Education**

Honduras is experiencing a crisis in education that calls into question the quality of service, the effectiveness of activities, and the importance of the school as a training ground for future generations. It also challenges the function of the teacher whose leading role in the classroom is in need of radical reform.

The measures the government is about to take seek to promote changes in the organizational structure and administration of the education sector that would enhance the profile and responsibilities of teachers and officials in education departments, with participation by parents in the monitoring school and teacher performance. The reforms are designed to link teacher pay to performance with the ultimate aim of increasing effective classroom days, improving the quality of education services, and raising retention rates.

Along these same lines, i) a ministerial resolution has been issued containing internal regulations on the functioning of departments in the Ministry of Education and the Local Education Development Associations (ADEL); ii) a Teacher Resources Administration System will be designed and implemented, together with a monitoring system to maximize the success of education management; iii) an audit of positions and salaries will be performed to ensure that every teacher hold the position to which he was appointed and is discharging the functions and duties assigned; and (iv) a ministerial resolution has been issued that officially establishes the basic national curriculum for official, semiprivate, and private education centers.

As an adjunct to these policy measures, and in light of the importance of financial variables in education reform, an action plan is on the drawing board that would give budgetary recognition to the use of SWAPS in education.

## **Health**

Honduras has made considerable headway in health, a reflection of a trend towards longer life expectancy, declining mortality, particularly amongst mothers and children under 5, the eradication of polio, and high immunization rates, with an ensuing sharp drop in the incidence of immuno-preventable diseases. Despite these successes, the general population suffers from seriously nutritional deficiencies, inequitable access to health services, and poor quality service. Because of these problems, the Ministry of Health feels that it must increase support for the private sector, boost capacity to supervise the work of health officials, and issue standards on the transfer of competencies, resources, and responsibilities to allow hospitals greater autonomy and flexibility in budget execution.

To this end, the government has prepared and officially introduced a 2021 strategic plan for the health sector with legal support for the gradual transfer of competencies,



resources, and responsibilities to civil society organizations, which in partnership with municipalities or community associations will provide autonomous support for hospital administration. This process will have the backing of budgetary forecasts that make the process financially sustainable.

Every effort will be made to spur an audit of positions and salaries of all Ministry of Health personnel so that the services network can be streamlined and public physical and human resources rationalized. These measures also seek to broaden coverage for the very poor and groups in remote areas.

As a supplement to these efforts, the Ministry of Health will be endowed with the legal tools to hire basic health service providers for very poor population groups. With the support of the human resources rationalization just noted, this measure will address problems of inequitable access to services and move forward towards the health targets set out in the PRS.

### **Evaluation**

The government is aware of the fundamental importance of monitoring the medium-term impact of short-term measures so that any necessary adjustments and corrections can be made. In this same vein, we are committed to financing and pursuing measures to gauge the PRS midterm targets as well as to making output impact assessments of the policy changes outlined in this Policy Letter. In this regard, a set of analytical tools will be used to observe changes in indicators with a breakdown by gender and geographic location (urban and rural).

### **3. Conclusions**

The government is committed to brining about macroeconomic stability in terms of the targets agreed on with the IMF for the remainder of the year. In this way, any commitments on policy measures for the social sectors will make it possible to make progress in the drive to achieve the poverty reduction targets contained in the PRS.

Yours sincerely,

*[signed]*

**William Chong Wong**

Assistant Secretary for Finance and Budget,  
Ministry of Finance